

# SUMMER ENERGY CONCERNS FOR THE AMERICAN CONSUMER

---

## HEARING BEFORE THE COMMITTEE ON COMMERCE HOUSE OF REPRESENTATIVES ONE HUNDRED SIXTH CONGRESS SECOND SESSION

---

JUNE 28, 2000

---

**Serial No. 106-136**

---

Printed for the use of the Committee on Commerce



U.S. GOVERNMENT PRINTING OFFICE

65-909CC

WASHINGTON : 2000

## COMMITTEE ON COMMERCE

TOM BLILEY, Virginia, *Chairman*

W.J. "BILLY" TAUZIN, Louisiana	JOHN D. DINGELL, Michigan
MICHAEL G. OXLEY, Ohio	HENRY A. WAXMAN, California
MICHAEL BILIRAKIS, Florida	EDWARD J. MARKEY, Massachusetts
JOE BARTON, Texas	RALPH M. HALL, Texas
FRED UPTON, Michigan	RICK BOUCHER, Virginia
CLIFF STEARNS, Florida	EDOLPHUS TOWNS, New York
PAUL E. GILLMOR, Ohio	FRANK PALLONE, Jr., New Jersey
<i>Vice Chairman</i>	SHERROD BROWN, Ohio
JAMES C. GREENWOOD, Pennsylvania	BART GORDON, Tennessee
CHRISTOPHER COX, California	PETER DEUTSCH, Florida
NATHAN DEAL, Georgia	BOBBY L. RUSH, Illinois
STEVE LARGENT, Oklahoma	ANNA G. ESHOO, California
RICHARD BURR, North Carolina	RON KLINK, Pennsylvania
BRIAN P. BILBRAY, California	BART STUPAK, Michigan
ED WHITFIELD, Kentucky	ELIOT L. ENGEL, New York
GREG GANSKE, Iowa	TOM SAWYER, Ohio
CHARLIE NORWOOD, Georgia	ALBERT R. WYNN, Maryland
TOM A. COBURN, Oklahoma	GENE GREEN, Texas
RICK LAZIO, New York	KAREN MCCARTHY, Missouri
BARBARA CUBIN, Wyoming	TED STRICKLAND, Ohio
JAMES E. ROGAN, California	DIANA DEGETTE, Colorado
JOHN SHIMKUS, Illinois	THOMAS M. BARRETT, Wisconsin
HEATHER WILSON, New Mexico	BILL LUTHER, Minnesota
JOHN B. SHADEGG, Arizona	LOIS CAPPS, California
CHARLES W. "CHIP" PICKERING, Mississippi	
VITO FOSSELLA, New York	
ROY BLUNT, Missouri	
ED BRYANT, Tennessee	
ROBERT L. EHRLICH, Jr., Maryland	

JAMES E. DERDERIAN, *Chief of Staff*

JAMES D. BARNETTE, *General Counsel*

REID P.F. STUNTZ, *Minority Staff Director and Chief Counsel*

(II)

## CONTENTS

---

	Page
Testimony of:	
Bradley, Justin D., Director, Environmental Programs, Silicon Valley Manufacturing Group .....	82
Brown, Mark H., Executive Vice President for Association and Club Services, American Automobile Association .....	85
Browner, Hon. Carol M., Administrator, Environmental Protection Agency .....	16
Frank, J. Louis, President, Marathon Ashland Petroleum, L.L.C. ....	88
Gale, Roger W., President and CEO, PHB Hagler Bailly .....	99
Gerken, Marc S., President, American Municipal Power, Ohio .....	103
Nemtsov, David M., President, Alliance to Save Energy .....	107
Pillari, Ross J., Group Vice President of Marketing Worldwide, BP Amoco .....	115
Pitofsky, Hon. Robert, Chairman, Federal Trade Commission .....	11
Ports, Michael, President, Ports Petroleum, Inc .....	117
Richardson, Hon. Bill, Secretary of Energy, Department of Energy .....	25
Slater, Hon. Rodney E., Secretary of Transportation, Department of Transportation .....	21
Thompson, Jerry, Senior Vice Resident, Citgo Petroleum Corporation .....	120
Material submitted for the record by:	
Bilbray, Hon. Brian P., a Representative in Congress from the State of California, prepared statement with attachments .....	150
Brown, Mark H., Executive Vice President for Association and Club Services, American Automobile Association, letter dated July 18, 2000, to Hon. Thomas Bliley, enclosing material for the record .....	304
Frank, J. Louis, President, Marathon Ashland Petroleum, L.L.C., letter dated July 13, 2000, to Hon. Thomas J. Bliley, enclosing material for the record .....	195
Gerken, Marc S., President, American Municipal Power, Ohio, letter dated September 11, 2000, to Hon. Thomas Bliley, Jr., enclosing material for the record .....	320
Mears, Mike, Vice President, Williams Transportation & Terminals, letter dated July 17, 2000, to Hon. Thomas Bliley .....	306
National Corn Growers Association, prepared statement of .....	317
Thompson, Jerry, Senior Vice Resident, Citgo Petroleum Corporation, letter dated July 18, 2000, to Hon. Thomas J. Bliley, enclosing material for the record .....	186
Vaughn, Eric, President and Chief Executive Officer, Renewable Fuels Association, prepared statement of .....	310





## **SUMMER ENERGY CONCERNS FOR THE AMERICAN CONSUMER**

---

**WEDNESDAY, JUNE 28, 2000**

HOUSE OF REPRESENTATIVES,  
COMMITTEE ON COMMERCE,  
WASHINGTON, DC.

The committee met, pursuant to notice, at 9 a.m., in room 2123, Rayburn House Office Building, Hon. Tom Bliley (chairman) presiding.

Members present: Representatives Bliley, Tauzin, Oxley, Bilirakis, Barton, Upton, Stearns, Cox, Deal, Largent, Bilbray, Lazio, Cubin, Rogan, Shimkus, Wilson, Shadegg, Pickering, Fossella, Blunt, Bryant, Hall, Boucher, Brown, Gordon, Rush, Stupak, Sawyer, Wynn, Green, McCarthy, Barrett, Luther, and Capps.

Staff present: Jim Barnette, chief counsel; Cathy VanWay, majority counsel; Joe Stanko, majority counsel; Hugh Halpern, parliamentarian; Kevin Cook, science advisor; Kelly Zerzan, majority counsel; Robert Meyers, majority counsel; Ramsen Betfarhad, majority economist, Robert Simison, legislative clerk; Elizabeth Brennan, legislative clerk; Peter Kielty, legislative clerk; Sue Sheridan, minority counsel; Alison Taylor, minority counsel; and Rick Kestler, minority professional staff.

Chairman BLILEY. The committee will come to order. I ask you to take seats, please.

The Chair recognizes himself for an opening statement.

As my colleagues and our guests know, we don't have full committee hearings very often, but it is a testament to this committee's importance to the House that every now and then an issue arises that demands the attention of all of us in one room. Today we are going to be talking about energy and consumer protection, the environment and tourism, and all in the exercise of our rights and responsibilities under the House rules to conduct oversight on matters within the committee's jurisdiction.

We are here today for answers. Our constituents back home are concerned about the sticker shock at the gas pump and the headlines they read about the electricity demands. I want to get to the bottom of what is causing price hikes for gasoline and what we in Congress can do about it. I also want to make sure that we have a steady, affordable power supply this summer and in the future.

When it comes to electricity, my views are well known. There should be a limited Federal regulatory role, but at the same time, all consumers, everyone from homeowners to high school principals to manufacturers deserve to have confidence that their needs will be met. We need to determine today whether they will have reli-

able electricity in the future or find out what this committee needs to do to make that confidence a reality.

The committee has a full day today, and the Chair would appreciate the cooperation of all members in completing our agenda. All members' opening statements will be made a part of the record. Without objection, so ordered. All members may insert materials relevant to today's hearing into the record. Without objection, so ordered.

[Additional statements submitted for the record follow:]

PREPARED STATEMENT OF HON. TOM BLILEY, CHAIRMAN, COMMITTEE ON COMMERCE

The Committee will come to order. The Chair recognizes himself for an opening statement.

As my colleagues and our guests know, we don't have full Committee hearings very often. But it is a testament to this Committee's importance to the House that every now and then an issue arises that demands the attention of all of us in one room.

Today we are going to be talking about energy. But we are also going to be talking about consumer protection, the environment, and tourism—and all in the exercise of our rights and responsibilities under the House Rules to conduct oversight on matters within the Committee's jurisdiction.

We are here today for answers. Our constituents back home are justifiably concerned about the sticker shock at the gas pump and the headlines they read about electricity demand. I want to get to the bottom of what's causing price hikes for gasoline and what we in Congress can do about it.

I also want to make sure that we have a steady, affordable power supply this summer and in the future. When it comes to electricity, my views are well known. There should be a limited Federal regulatory role. But at the same time, all consumers—everyone from homeowners to high school principals to manufacturers—deserve to have confidence that their needs will be met. We need to determine today whether they will have reliable electricity this summer and in the future—or find out what this Committee needs to do to make that confidence a reality.

The Committee has a very full day today and the Chair will appreciate the cooperation of all Members in completing our agenda.

Without objection, all Members' opening statements will be made part of the record. So ordered. Without objection, all Members' may insert materials relevant to today's hearing into the record. So ordered.

The Chair now recognizes the gentleman from Michigan for an opening statement.

---

PREPARED STATEMENT OF HON. W.J. "BILLY" TAUZIN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF LOUISIANA

Thank you Mr. Chairman, and I thank you for holding this hearing on such an important issue on such a timely basis.

It is only fitting that this is a Full Committee hearing today because the issue of rising gas prices falls within the jurisdiction of almost all of our Commerce subcommittees.

Mr. Chairman, I have quite a few questions today for our witnesses, and I know that almost every member here today has questions of their own, so I will keep my opening remarks very brief.

There is really only one issue before us today: whether the current panoply of state and federal regulations governing gasoline production in America today—including reformulation standards and taxes—are affording our nation of consumers with reasonable prices at the pump.

The answer, of course, is NO.

Now there are a number of factors that cause gas prices to fluctuate—some are local while some are of national consequence. In the final analysis, however, I have concerns that the reformulated gasoline program is the real culprit here as opposed to the activities of oil companies.

Despite that gas prices have been unregulated for years, what we have here is a clear case of regulation increasing the price of gasoline. As the requirements increase...it becomes more difficult and costly to make gas that meets formula and performance standards...the supply of gasoline decreases as a result...and naturally, prices go up. It's really as simple as that.

On the record, I want to say that I am not fooled by the purported reasons for or the scope of the FTC, administration induced, investigation. To attribute the rise in gas prices to anything other than this administration's failure to prevent escalation is really laughable to me.

I would say to the Administration that energy policy is as important to Louisiana's Third District as any issue before Congress. As a result, I am as well versed in energy issues than almost any other issue I deal with, and I know better than to believe that some conveniently fabricated collusion is all of a sudden the reason for rising gas prices.

For years, the reformulated gas standards have been driving prices up by increasing the cost of production, and now all of the sudden...now that it's clear we have a problem...the Administration, almost overnight, now wants us to believe that a handful of bad-actor oil companies have caused the problem overnight. Never mind the faulty EPA science...never mind the Administration's poor judgment.

I, for one, have never witnessed such a political ploy in my entire career as a Congressman. How convenient a scenario!

Now, let's talk about this sudden phenomenal and mysterious collusion that the Administration hasn't said a thing about until just last week?

The Administration now asserts absolutely that collusion is to blame, yet needs to investigate as a means of gathering more information to justify its position.

There are two observations I can make about that. For one, the research usually comes first, and then dictates the conclusion. This Administration, however, prefers to make a public assertion for political reasons, and then go selectively fish for supporting data. Second, I'm not sure what new, earth-shattering information this investigation will produce that is not already included in the FTC's record of review of the BP/Amoco, Exxon/Mobil, and Shell/Texaco mergers.

Make no mistake, if the White House's concerns about collusion were genuine, or at least consistent with its public position, then the FTC would be doing much more than just investigating! It would be out trying to enjoin this collusion under the broad statutory authority that it claims to have whenever doing so facilitates the White House's agenda.

The most unfortunate thing, however, about this investigation is that it will not solve the nation's problems this Summer. While the Administration remains busy supervising the FTC's insipid development of a phantom scapegoat, America will continue to pay highly inflated gas prices across the country under the mistaken belief that once Mr. Gore deals with these few bad actors that everything will magically return to normal. What nonsense!

Fortunately, I think that the American public is smart enough to recognize what's going on here. Things don't go so awry on a nationwide basis as a result of some isolated and local bad faith, even if there is some merit to the FTC's charges—which, as I've said, are suspect at best in light of the timing of the FTC's enlightening discovery.

Today, I'm here to send the message to Mr. Gore that I don't buy it. And, I will do my best to ensure that the public doesn't buy it either.

With that, Mr. Chairman, I yield back, and I look forward to today's discussion.

---

PREPARED STATEMENT OF HON. MICHAEL BILIRAKIS, A REPRESENTATIVE IN  
CONGRESS FROM THE STATE OF FLORIDA

Thank you Mr. Chairman.

First, let me commend you for scheduling today's hearing on summer energy concerns for the American consumer. Rising gasoline prices is an issue that certainly has the attention of my constituents and the rest of the American public. I believe it is imperative for us to examine the causes behind these rising prices.

Earlier this year, the Energy Information Agency predicted that, even barring major refinery disruptions this summer, average retail gasoline prices could reach a monthly average of \$1.75 to \$1.80 per gallon. In some parts of the country, gasoline prices have already exceeded these predictions.

In my district, the price for a gallon of regular gasoline ranges from \$1.51 to \$1.57. A gallon of premium gasoline can cost as much as \$1.78. A year ago, a gallon of gas cost just 98.2 cents in Florida. It is easy to understand why so many Americans are seeing red when they visit their local gas station.

Many factors may be contributing to the rising price of gasoline. One matter under review today has been a particular focus of the Health and Environment Subcommittee—implementation of the reformulated gasoline program (RFG).

Over the past two and a half years, we have held three hearings which specifically addressed the RFG program. At our most recent hearing, on March 2, 2000, we ex-

amined several questions concerning national implementation of the program, including water contamination associated with the fuel oxygenate, methyl tertiary butyl ether, or MTBE.

Today, I think we must examine the price experience of Phase II of the RFG program in the Midwest and the specific causes for the runup in gasoline prices in that area. But we must also closely review the Environmental Protection Agency's continuing implementation of the RFG program and why it did not, or could not, predict the difficulties which have been experienced in Chicago and Milwaukee.

The RFG program is a mature program. It has been in law for almost ten years and final regulations were issued in February of 1994. It is therefore disturbing that it wasn't until early June, or after the final downstream implementation date of the Phase II program, that EPA began to ask why refiners were having difficulty in meeting the demand for RFG and why prices had escalated far beyond other areas of the country. While I have not drawn any conclusions on this matter, I also find it hard to believe that there were not some signs on the horizon of the difficulties that lay ahead.

I also remain concerned regarding the Agency's apparent inability to move forward with any determination concerning a request from California for waiver of the 2 percent federal oxygenate standard for RFG. EPA has been "reviewing" this matter for 15 months. It has every last bit of data it requested from the State of California since early February. And yet, Administrator Browner last week would not even venture a tentative date as to when the Agency would complete its work.

Last May, I indicated that EPA inaction on this matter looked like "stonewalling" on the part of the Agency. Today, unless I hear differently from the witnesses, I think the EPA's intransigence on this matter is more like the Great Wall of China stretching endlessly into the distance with no end in sight.

It is simply not credible or believable that the Agency cannot address this technical issue when, in the next breath, it acts to promulgate major revisions to air standards, new fuel standards for cars and diesels, and endless paper and litigation on the ozone transport rule. Whatever the reason for inaction, at this point, EPA's inaction cannot be based on questions of technicality or difficulty, but rather must be based on deliberate intent or total incompetence.

I am anxious to hear from today's witnesses and look forward to working with my colleagues on this important issue.

Thank you, Mr. Chairman.

---

PREPARED STATEMENT OF HON. STEVE LARGENT, A REPRESENTATIVE IN CONGRESS  
FROM THE STATE OF OKLAHOMA

Mr. Chairman, you are to be commended for holding this very important full committee hearing on two issues that will predominate this summer's headlines—gas prices and electricity reliability. I want to welcome our illustrious panel of witnesses, and pay a special word of welcome to one of my constituents who will be testifying on the second panel, Mr. Jerry Thompson, Senior Vice President of Citgo.

Mr. Chairman, in the interest of time, I will keep my opening remarks brief, over the course of the past few weeks we have seen of barrage of political finger pointing because of increased gas prices. I'm sure there is enough fault to go around, but Americans have grown weary of the political blame game. They just want congress and the administration, as well as industry, to work together to find a long term solution to ensure reliable and affordable energy prices.

This morning we will also look at the constraints being placed on our national electric transmission system and the current balkanization of the grid. As an eternal optimist, I want to say to all those skeptics and nay sayers who believe that we cannot pass comprehensive restructuring legislation which ensures open and non-discriminatory access to the grid, I am confident this committee, will in fact, prove you wrong.

Both Chairman Bliley and Chairman Barton, as well as all members who have worked on this issue, are to be commended for their diligent efforts.

Mr. Chairman, I look forward to having a constructive dialogue with our witnesses, and again thank you for holding this very important hearing.

---

PREPARED STATEMENT OF HON. RICK LAZIO, A REPRESENTATIVE IN CONGRESS FROM  
THE STATE OF NEW YORK

Mr. Chairman, I applaud you for holding this hearing on this critical issue today. I look forward to the insights and suggestions from our witnesses.

Mr. Chairman, there is a gas crisis in New York and America today. And what New Yorkers and all Americans deserve—immediately—is relief from escalating fuel prices. The bottom line is that we need to take action to lower gas prices—now.

Mr. Chairman, New Yorkers are being gouged at the gas pump. The average price per gallon in our state is up to \$1.70. These outrageous gas prices affect all New Yorkers, making driving more expensive, and raising the cost of every item moved by truck—from food to clothes to household goods.

Many small, fuel-intensive businesses already are suffering the effects of high gas prices. For a small company that consumes 50,000 gallons of diesel fuel in a month, the increase in prices in the past year will cost that company an additional \$40,000 per month. High gas prices have the most impact on poor, elderly, and rural New Yorkers.

Mr. Chairman, the CATO Institute calls the flat 4.3 cents per gallon federal gas tax one of the most regressive of all federal taxes. Most New Yorkers earning less than \$10,000 per year commute to work in cars, so a flat tax rate falls disproportionately on these poor as a percentage of their income. Rich or poor, you still pay the same amount at the pump. Rich or poor, you still have to drive about as far to work and to the grocery store. But our lower income families have less money with which to pay at the pump.

The Tax Foundation says excise taxes such as the gasoline tax are five times more burdensome for lower-income households than they are for wealthy taxpayers.

Here is what I believe we need to do—now.

First, we must repeal the Clinton-Gore gas tax. The gas tax was established in 1993. The Clinton-Gore gas tax increase costs New Yorkers over three hundred million dollars a year.

Second, the Administration must begin pressuring the OPEC nations to take real steps to increase production, increase the supply of oil, and help lower prices. In 1991, America committed its prestige and its blood to help protect many of the Middle East oil-producing nations. It is time for us to call in that debt.

Third, we need to immediately open the Strategic Petroleum Reserve to increase the supply of fuel on the market. The reserve was created to ensure a stable supply of oil during a crisis. Let me tell you—gas prices approaching \$2.00 a gallon means a real crisis for New Yorkers.

Some have expressed concern that eliminating the federal gas tax would affect the amount of money the states get for road construction. This year's federal budget surplus is nearing \$250 billion. The surplus will likely total \$2 trillion over the next ten years. The taxpayers helped build this surplus—they deserve to get some benefit from it. We should use part of the surplus to offset any reduction in federal highway funds.

Mr. Chairman, last night I, and the majority of this House, voted again to reauthorize the Strategic Petroleum Reserve and to create a Northeast Regional Heating Oil Reserve. I have been an early and consistent supporter of the Northeast reserve, but I recognize that it alone is not a complete solution. I look forward to working with our colleagues in the other body to make that reserve a reality.

Mr. Chairman, this is a great nation and it deserves great things from its leaders. This gas crisis was no surprise. We in New York saw it coming when we watched our heating bills double overnight last winter. We cannot understand how the administration could have sat by and done nothing to avoid last winter's heating oil crisis from becoming this summer's gas crisis.

Mr. Chairman, you are to be commended for holding this hearing, and I look forward to working with you and this Committee on this important issue.

---

PREPARED STATEMENT OF HON. BARBARA CUBIN, A REPRESENTATIVE IN CONGRESS  
FROM THE STATE OF WYOMING

The United States now relies on foreign imports for 56% of our crude oil needs. In the last eight years domestic oil production has declined 17%. A decade ago there were over 650 drilling rigs exploring for oil in the U.S., today there are only 153. The popular scapegoat for high gasoline prices are our Middle East allies of Desert Storm and the remainder of OPEC nations. But much of the responsibility for our addiction to foreign oil is the result of policies emanating from the Clinton/Gore Administration. This administration has formulated an anti-energy policy that for eight years discouraged oil exploration and reduced our domestic energy to a shadow of its former self. As a result, Americans are paying for that 10,000 mile economic intravenous drip at the pump and at the cash register. Transportation costs are skyrocketing; everything that rolls, floats, or flies costs more to operate. From food and clothing to computers and telecommunications equipment—all goods and

services cost more. It's not just the gas for your family car; our national security and health of our economy are at stake.

Wyoming has benefited from a rise in oil prices. But we are once again on the upswing of the infamous roller-coaster economy so prevalent in a State dependent on natural resources. The downturn surely will follow. I do not support artificial energy prices—whether low from a temporary oil glut, or high from withholding crude from the market. We must have an energy policy that creates a stable market to support a vibrant domestic energy industry while providing affordable energy to power our expanding economy. The law of supply and demand is basically immutable. Neither the President nor Congress can force prices lower when demand remains constant or increases at the same time supplies have decreased. Rather we should attack the problem from both ends of the equation.

From the supply side, we should require the Clinton/Gore Administration to disclose, in a report to Congress, the extent of domestic oil and gas resources which lie beneath public lands and outer continental shelf (OCS) areas deemed off-limits to exploration and development. This showing must include undiscovered resources estimated by objective scientific means as well as known reserves. Likewise, the report should include an assessment of domestic hydrocarbon resources which are not getting to markets in a timely manner because of extraordinary delays in lease issuance and/or permitting of wells and pipelines, such as we have already seen with respect to coalbed methane in the Powder River Basin. Energy experts agree the public lands and OCS have the best potential for significant new discoveries of oil and gas anywhere in the United States. In this manner, Congress will have baseline for policymaking regarding federal oil and gas supplies. Other factors for increasing domestic supplies include tax incentives for companies to spend more of their exploration budgets here at home rather than in foreign countries. Senator Hutchinson has introduced such a package which deserves debate, passage by Congress and a signature of the President. On the demand side, Congress and the Administration should continue efforts for increased efficiencies in power generation, transmission and usage. When calculating the demand for oil and natural gas, we must not neglect the significant role of coal and uranium resources in electric power generation, including research and development in cleaner burning of fossil fuels. Likewise, the Administration must acknowledge the impact of an upcoming decision to classify fly ash from coal-burning plants to be a hazardous substance. Coal-fired electricity rates will increase significantly if this environmentally benign ash cannot be used in the reclamation of the very mines whence it came. There are a number of directions we can go to secure more domestic energy. The bottom line is we have the resources and the technology to responsibly produce the energy America needs to power industry and fulfill the needs of all Americans. Future generations will pay an even higher price down the road if we fail to answer the call.

---

PREPARED STATEMENT OF ROY BLUNT, A REPRESENTATIVE IN CONGRESS FROM THE  
STATE OF MISSOURI

Mr. Chairman: When it comes to concerns about gasoline and diesel prices, my constituents in the Seventh District of Missouri aren't interested in fingerpointing, scapegoating, or demagogery. MTBE and RFG aren't what's being discussed by husbands and wives around the kitchen tables. They want lower fuel prices, stable supplies, and they want it now, not 6 months or a year from now.

Families want assurances that they aren't going to have to decide whether to put gas in their car to go to work or food on the table to feed themselves. Farmers want to make sure that they can afford the fuel to operate their tractors to plant and cultivate crops now but still be in business when it comes time to harvest this fall. Small business owners are concerned that their customers won't have the money to buy their goods and services or that the higher cost of transportation and supplies will drive them out of business. Members of volunteer fire departments are even telling me that higher fuel prices are reducing the number of firefighters who are showing up to help out their neighbors in time of need.

Higher fuel prices impact everyone. Mr. Chairman, I'm supporting an immediate suspension of the federal tax on motor fuels, 18.4 cents on gasoline and 24.4 cents on diesel fuel. That's a tax cut that will immediately go directly into the pocketbooks of every American family that drives a car or a truck.

Because as a nation we can't afford to stop building and maintaining roads, I also propose that we reimburse the Highway Trust Funds the dollars we would have collected in the same 90 day period. This suspension transfers over \$7 Billion dollars out of the Treasury Department on Pennsylvania Ave and moves it to Front Street

America, out of the reach of those in Washington who have never met a new or expanded entitlement program they couldn't love.

But once we've got fuel prices under control, the American people are demanding the Truth.

They want to know how the three-fold failure of the Energy Department to build adequate international relationships with our foreign oil suppliers, to encourage development of domestic petroleum supplies and to promote alternative energy systems led to higher motor fuel prices.

They want to know why the Energy Department was napping—in the words of Secretary Richardson—as the cost of foreign oil virtually tripled in less than two years and as inventories of US fuel supplies reached their lowest levels in many years.

They want to know whether there is any truth to published reports that the current Administration encouraged OPEC production cuts to help some countries pay off debts to US banks.

They want to know whether there's been price gouging by refiners and retailers.

They want to know why the Energy Department claims that reformulated gasoline only costs pennies more per gallon, the Congressional Research Service estimates the cost at about 25 cents per gallon, but the marketplace placed the cost at as much as 40 cents per gallon.

And in my Congressional district people want to know why gasoline and diesel fuel being unloaded at two terminals in our district were priced as much as 30 cents more per gallon than fuel a couple of hundred miles away.

Mr. Chairman, our citizens not only want the truth, they are demanding the truth. My colleagues, I can assure you that the American public is as mad as hell, and they are going to hold what they perceive as "do nothing" politicians accountable.

I call on the Senate to quickly approve the Oil Price Reduction Act of 2000 which would reduce, suspend, or terminate any foreign aid, include military assistance, to any country determined to be engaged in oil price fixing to the detriment of the United States economy.

I call on my colleagues to join with me in supporting a 90 day suspension of federal motor fuel taxes.

I also want to call on the members of the President's Administration to pursue with utmost urgency your review of the causes of the current increase in fuel prices and to either make the necessary changes yourself or come back to this Congress with concrete proposals for reducing prices at the earliest date possible.

---

PREPARED STATEMENT OF HON. JOHN D. DINGELL, A REPRESENTATIVE IN CONGRESS  
FROM THE STATE OF MICHIGAN

Mr. Chairman, I appreciate this hearing and hope that it produces a serious discussion of the issues at hand. While it might be tempting to engage in a festival of fingerpointing to assign responsibility for the recent rise in gasoline prices, we might find at the end of this hearing that some of those fingers will be pointed at us.

In the last few weeks, the price of a gallon of gasoline in some Midwestern cities jumped 60 cents overnight. A number of explanations for those increases have been offered.

One is that a new reformulated gasoline requirement is responsible. Reformulated gasoline had its origins in the Clean Air Act Amendments submitted to the Congress by one George H.W. Bush, and signed into law by him in 1990. We had a spirited debate in this Committee on this issue—Secretary Richardson remembers it well, because he was then one of our members—and I warned at the time that reformulated gas might be more expensive or produce distribution problems.

Nonetheless, there is no credible evidence that the reformulated gas requirements are entirely or even primarily responsible for the recent price spike. In fact, in some areas reformulated gas is cheaper than regular gasoline.

A second explanation is that we are having supply problems, specifically, accidents causing the interruption or curtailment of service at two pipelines. As Secretary Slater knows, I have had some choice words of criticism for the competence of the Office of Pipeline Safety. But I also warned, when this Committee considered pipeline legislation almost two years ago, that we were blissfully ignoring safety. The Committee, of course, chose to ignore my warnings instead. We've since seen pipeline accidents take the lives of children in Washington state, and we've been made aware that there is indeed an economic component to pipeline safety.

We've also seen accusations and insinuations of good old-fashioned price gouging by the oil companies. Chairman Pitofsky's agency is in the process of investigating those questions, and while I wouldn't prejudge its results, I have a strong suspicion that at a minimum, what we have here are some practicing capitalists.

Finally, the Administration has been accused of lacking an energy policy. That's a charge that can also be leveled at a Congress that has not only failed to reauthorize the Strategic Petroleum Reserve, but whose leadership actually proposed eliminating SPRO and disposing of its petroleum contents. The Congress also proposed abolishing the Energy Information Administration, our first line of defense against our own ignorance on energy matters.

There is, frankly, enough responsibility to go around. The harsh fact is that we only pay attention to energy issues when there is a price spike or a supply disruption. No matter where our discussion leads us today, I would hope that we look at these issues as longer term, sustained projects. Many of the proposed solutions currently under discussion are simply designed to get us through the next election.

---

PREPARED STATEMENT OF HON. RALPH M. HALL, A REPRESENTATIVE IN CONGRESS  
FROM THE STATE OF TEXAS

Mr. Chairman and Members of the Committee—I thank you for holding this hearing today. Last week I requested that you schedule this hearing to take testimony from witnesses who have actual knowledge of how gasoline and other refined petroleum products are produced, refined and marketed. In that letter I urged you to hold this hearing now so if we learn there are problems with how these markets are operating, we have enough time before adjournment to find the appropriate remedies, if there is evidence of price collusion among sellers. While price gouging is not illegal, perhaps we can put the spotlight on it if it is occurring in the supply chain.

In the last week however, the rhetoric has escalated to a fever pitch, with Democrats blaming Republicans, Republicans blaming Democrats, and consumer groups blaming the oil companies about the situation we find ourselves in today. We in the Congress are fine practitioners of the blame game. But I think it's time we look inward at ourselves, at this government. And if we do, I believe we will find that for a long time we have been negligent in our responsibilities to ensure a reliable supply of crude oil at stable prices. It may be, as the cartoon character Pogo once said, "We have met the enemy and it is us."

Nobody likes lower energy prices than I do, but the low prices of last year were every bit as much of a market signal that something was wrong as the relatively high prices that we see posted at the pump are today. The oil industry and its industry economists foresaw this escalation of prices more than a year ago. And yet here we are today castigating them for what they told us would ensue if we didn't act. As a government we sat idly by, and not only did nothing, but we actually allowed domestic production to decline significantly, because we thought that in low prices there was a real free lunch. Well, the check now has to be paid.

We have not had the courage to pursue what really ought to be our objective—and that is stable oil prices. It has taken us years of inaction to dig ourselves into this quagmire, and it will take some years to get us out of it. But we can make a commitment, while prices are high, to enact legislation to provide stability in oil prices—even after prices have declined. We simply can't continue to be as short-sighted as we have been to date.

What needs to be done? For starters we need to pass the tax package that has been championed by Wes Watkins of Oklahoma. It's not all the industry needs, but it's a start. With the record budget surpluses projected over the next ten years, surely we can afford the revenue loss that will benefit our constituents much more than it will cost them.

We need to enlarge our drilling options. An offshore rig is never nearly as unsightly as a ship laden with American soldiers and sailors going off to fight in a foreign land for energy. Make no mistake—the United States will go to war for energy—when ours is completely depleted.

Japan in the late 1930s was forced to go to Malaysia for energy after Secretary of State Cordell Hull and Secretary of War Henry Stimson cut off their supply of energy. Hitler went east. We also sent 400,000 troops to Kuwait but never mentioned the real reason we sent them there—to keep a bad person and an unfriendly nation from controlling one-half of the world's energy.

I'm an environmentalist, but I don't like to think of body bags. We are nearing a day and time when realism tells us to protect an environment by serving our country and by drilling on the Alaskan North Slope, offshore and on federal lands



now locked away from exploration and production. The signs that the environmentalists hold up saying “No Nukes” can say “No Wars.”

There is something we should include if we adopt a new energy policy—and that is to provide an incentive to look for energy and a reward for finding it.

We also need to stop arguing about whether it's fossil energy or renewable energy that ought to be in our energy future. The fact of the matter is, we need them both! Let's cough up the dollars to support renewable energy technology and energy efficiency and support fossil energy R&D, too. There's much more oil and gas to be produced in this country, but we have to develop the technologies to extract it at reasonable cost. Coal also deserves support. After all, our coal resource will be here long after the oil and natural gas resource base has been depleted.

Mr. Chairman, we are the envy of the world with our diverse energy resource base. France, Germany and Japan would kill to have our domestic energy resources, and the people we have who are pursuing research in advanced combustion technologies, renewable energy resources and energy efficiency. Many writers say that, even at current prices, by world standards gasoline is a big bargain. They tell us to try filling up in France or Italy and see what you pay. Even so, we need to increase our domestic production capability to help bring about a more stable market.

Let's take a hard look at how these markets are working and make certain that they are working properly. That is our job here today. I am willing to work with you and the other members of the Committee to move any legislation that will deal with the longer-term, more fundamental problems that prevent us from achieving stable prices.

---

PREPARED STATEMENT OF HON. SHERROD BROWN, A REPRESENTATIVE IN CONGRESS  
FROM THE STATE OF OHIO

Thank you, Mr. Chairman. By now we have already heard many explanations for high gasoline prices. Maybe we will learn something new from this hearing. But I have yet to hear a satisfactory explanation for the dramatic jump in gas prices in the Midwest earlier this month.

I look forward to the results of the Federal Trade Commission's investigation into possible antitrust activity in the Midwestern gasoline markets. I have urged the President to ensure the FTC has all the resources it needs to conduct a speedy investigation, and the Justice Department is poised to take enforcement action quickly if any wrongdoing is found.

But I suspect these huge price spikes can be explained in one word: price-gouging. With supplies tight and the summer driving season beginning, the oil industry saw the opportunity to reap windfall profits at the expense of our constituents. My constituents don't have any trouble identifying the price increases as price-gouging. They have been calling me, and demanding to know what I'm doing about it. They're not happy when I tell them, “Price-gouging is not illegal.”

While price-gouging is legal, it isn't right. On April 10, 1962, six major US steel producers announced a sudden increase in steel prices. President John F. Kennedy was absolutely furious. He denounced the price increase in no uncertain terms. He said,

Price and wage decisions in this country, except for a very limited restriction in the case of monopolies and national emergency strikes, are and ought to be freely and privately made. But the American people have a right to expect, in return for that freedom, a higher sense of business responsibility for the welfare of their country than has been shown in the last two days.

Some time ago I asked each American to consider what he would do for his country and I asked the steel companies. In the last 24 hours we had their answer.

Three and four days later, in response to President Kennedy's ringing denunciation, the steelmakers canceled their price increases.

Distinguished Administration witnesses, I call on you and the President to use the same bully pulpit, as President Kennedy did, to call for lower gas prices *now*.

I also urge the Republican leadership in this Congress to call for lower gas prices immediately. Remember that you represent American citizens—workers, small business owners, families—not just oil companies. Stop telling us the Administration doesn't have an energy policy. President Reagan and President Bush didn't have an energy policy any more comprehensive than President Clinton's.

It is truly ironic that the Republican leadership wants to eliminate the Department of Energy, refuses to invest in energy efficiency, and refuses to invest in developing new sources of energy renewable sources. Yet the Republican leadership tells

the public the high prices at the gas pump are because the Democrats we don't have an energy policy.

Let's get these prices down as quickly as possible, and make sure we work together on our long-term energy policy. Thank you, Mr. Chairman.

---

PREPARED STATEMENT OF HON. FRANK PALLONE, JR., A REPRESENTATIVE IN  
CONGRESS FROM THE STATE OF NEW JERSEY

Mr. Chairman, this hearing is supposed to address "summer energy concerns." Well, I am concerned about what we are facing and are likely to face this summer—in terms of exorbitant gas prices and impending blackouts and brownouts—and what we, particularly in the northeast, are going to face in the fall with respect to heating oil prices.

However, it seems to me these crises could be, or could have been, avoided. Yes, we may be witnessing some price gouging by the oil companies, and I hope we'll explore that angle in depth here this morning. Yet, this committee last addressed a comprehensive energy policy in 1992 with the Energy Policy Act of 1992. And, for the first 4.5 years the Republicans controlled this Congress, they conducted no oversight on oil & gas policy at all. Moreover, the first hearing of this Congress was on the Iraqi oil-for-food program, during which Mr. Barton declared oil prices were too low. Our chairman also stated he knew OPEC was going to cut supply but took no action to protect our Nation's consumers. That was over one year ago.

The Republicans now claim to have an energy policy—their "sham" policy consists of trying to abolish the Department of Energy, cutting funding for renewable energy, energy conservation measures, and fuel-efficient vehicles far below the Clinton-Gore Administration's requested levels, and repealing fuel taxes that pay for our nation's transportation infrastructure.

Mr. Chairman, I am concerned about rising gas prices and about the reliability of our electric transmission system. Supplies are already barely available for gasoline, and natural gas supplies are going to be tight for heating, cooling, and keeping the lights on this summer and fall. Mr. Chairman, as we will hear from at least one witness (Alliance to Save Energy), the only way to address these problems in the near-term, as well as the long-term is to look at energy conservation, alternative energy resource development and other measures to reduce the burden on the grid and on our fossil fuel resources.

We must take a long-term approach to ensure this Nation's energy independence and energy security. The Republicans have done everything they can to gut Democrats' and the administration's attempts to do so.

Let me also briefly address two other issues. First, I will examine the reformulated gasoline issue. Reformulated gasoline now costs only approximately five cents per gallon more than conventional gasoline—and this includes the newest, more stringent requirements and includes blending with ethanol. But, in case anyone feels this is too much to pay, I have joined my colleagues, Mr. Barrett, Mr. Kucinich, and Mr. Baldacci in introducing legislation, H.R. 4739, which addresses the Unocal patent for reformulated gasoline. Unocal can be seen to have a monopoly on the blending process for reformulated gasoline. Other refiners have cut back supply to avoid paying high prices for the license to these patents. Our legislation would enable the Attorney General to extend authority she currently has under the Clean Air Act to the reformulated gasoline program, so that these patents would be more readily available to all refiners, thereby enabling refiners to increase supplies, and in turn, bring down prices.

Finally, let me discuss pipeline problems which have disrupted the flow of petroleum products to the midwest. I look forward to hearing from the Department of Transportation (DOT) on this aspect of today's hearing. I am fairly confident that these breakdowns have likely also led to the recent increase in gas prices. I have long fought for tougher pipeline safety legislation to prevent such accidents. Now, I am working with Rep. Inslee to introduce strong pipeline safety legislation that would require inspections to detect corrosion of hazardous liquid pipelines. These inspections should prevent the type of accident that occurred with the "explorer" pipeline. My legislation also contains strong enforcement provisions to further prevent operators from trying to avoid complying with requirements. And, as many of you know, I have passed one-call legislation so that excavators "call before they dig" to also try to avoid pipeline interruptions.

Thank you, Mr. Chairman.

PREPARED STATEMENT OF HON. BILL LUTHER, A REPRESENTATIVE IN CONGRESS FROM  
THE STATE OF MINNESOTA

I would like to thank the Chairman of the Committee for holding this important hearing. During this hearing I would like to address two concerns with regard to soaring gasoline prices in Minnesota and the Midwest:

First, the Federal Trade Commission has recently launched an investigation into possible price collusion in Midwestern markets. The state of Minnesota will be included within the Midwest geographical region that the Commission will investigate. I am very concerned over allegations of price collusion, and I hope this hearing will provide Chairman Pitofsky with an opportunity to set forth the general structure of the FTC's investigation. I realize and appreciate the sensitivity of disclosing preliminary information, and I certainly respect the FTC's discretion in this regard. But to the degree that he is so empowered, I would appreciate it if Chairman Pitofsky could inform the Committee of how the FTC generally plans to investigate the rising prices on the American consumer.

On this point, I would like to submit into the record an article appearing in the June 23 edition of the Minneapolis Star Tribune. That article reports that an unnamed major oil company, which controls 40% of the Twin Cities market, was going to reduce gasoline prices by 7 cents a gallon the next day. This sudden action came on the heels of another news report two days earlier that announcing that the FTC would include Minnesota within its regional investigation of price collusion. Mr. Chairman, it is my hope both Chairman Pitofsky and our witnesses can explain this sudden drop in prices.

My second concern is with Phase II of the reformulated gasoline program or RFG. Many in Congress have blamed the Administration and the EPA for the mandates under the Clean Air Act—in particular, they blame the EPA's recent regulations that require certain metropolitan areas to sell the cleaner-burning summertime RFG. Phase II of this program became effective in January of this year and Phase II RFG was due at the pump on June 1st. This timetable roughly coincides with the spike in gasoline prices. However, no metropolitan area in Minnesota was required to participate in Phase II, nor did Minnesota elect to opt into the program on a statewide basis. Nonetheless, Minnesota gasoline prices soared to \$1.90 a gallon, a price on par with prices in Milwaukee and Chicago. It is my hope that EPA Administrator Browner and our witnesses can explain how RFG has adversely affected gasoline prices in Minnesota, when the entire state is not under any of Phase II's requirements.

It is vitally important that Congress address the needs of the American consumer in this matter. Whether it be price collusion, reformulated gasoline, defective pipelines, or general market economics, the American consumer needs relief. This can only be accomplished through a thorough understanding of the causes of the current situation. I therefore look forward to hearing all of the testimony.

Chairman BLILEY. Mr. Dingell is not here, so we will begin with our witnesses. So we will start on the left with the Chairman of the Federal Trade Commission, Mr. Pitofsky; followed by Ms. Browner of EPA; Mr. Slater, the Secretary of Transportation; and Secretary Richardson.

**STATEMENT OF HON. ROBERT PITOFSKY, CHAIRMAN,  
FEDERAL TRADE COMMISSION**

Mr. PITOFSKY. Thank you very much, Mr. Chairman. I am pleased to have this opportunity to discuss with members of this committee the matter of recent price increases in the price of gasoline, particularly in the Midwest. As you know, motorists in the Midwest have been subjected to remarkably large and abrupt price spikes in gasoline prices. In Chicago, prices for regular reformulated gasoline hit a high of \$2.13 on June 20 and reportedly as high as \$2.50 at some gas stations. In Milwaukee, on June 20 the price was \$2.02. By the middle of June, motorists living in the Midwest States including Illinois, Wisconsin and Michigan were paying the highest retail gasoline prices in the United States. And the question from all of us is why is this happening?

Some have speculated that the price increase in the Midwest is occurring because of the decision of the OPEC countries to curtail production, because of the increase in demand for crude oil in Asia as those economies recover, or the increase in the demand in the United States as a result of the summer driving season. But all of those factors should affect the east coast, the west coast and the Midwest approximately in the same way. Therefore, it seems unlikely to me at this time that these factors would account for price increases for reformulated gas in the Midwest that are 30, 40 or even 50 cents higher than for reformulated gasoline in other parts of the country.

Others have suggested that the price increases relate directly or indirectly to the decision originally made by Congress and implemented by the EPA to introduce Phase II summer blend gasoline into particular parts of the Midwest. The Phase II gasoline used in the Midwest involves a new ingredient not used in many other parts of the United States and may have caused adjustment difficulties in the production process and may have decreased refinery yields. There have also been some transportation difficulties in two pipelines serving the Midwest, although one of those pipeline difficulties occurred in March and appears to have been largely, if not completely, solved, and the other involved a rather minor spill. But small disruptions of supply in a tight market can cause severe price fluctuations.

Finally, some have suspected that the Midwestern price increase is as a result of some sort of collusion or conspiracy among producers in the area or noncollusive opportunism by refiners and other marketers taking advantage of market dislocations resulting from the introduction of a new form of gasoline.

The FTC's decision to initiate a formal investigation of gasoline prices in the Midwest has met with strong bipartisan support from Members of Congress and from the administration. We have heard from over 100 Members of Congress, both sides of the aisle, Republican and Democratic, urging or supporting this investigation. We have begun to serve subpoenas on major oil companies operating in the Midwest, we will serve additional subpoenas in the near future and will eventually take testimony under oath.

One of the virtues of an investigation like ours is that we can come down from the mountaintop of speculation and suspicion and look more closely at how these substantial price increases came about. Among the issues that we will address are the following: Assuming that the price increases were triggered at the refinery or terminal levels, which firms led off the price increases and when, and why did they move in that way? Which firms followed the initial price increases and in what time period?

As to companies that led or followed, what were their levels of inventory of conventional gasoline and reformulated gasoline at the time decisions were made to increase prices? Were those levels lower than usual?

To what extent did the introduction of reformulated gasoline increase the costs of refiners and terminal outlets? What were the production levels in the months leading up to the introduction of reformulated gasoline, and what were the production levels since?

Assuming that demand for gasoline is relatively inelastic, that is in the short run, almost all motorists and small businesses will pay the additional money rather than discontinue driving or abandon their cars, what were the reasons for the price increase?

Finally, is there any direct evidence of collusion?

The good news is that prices at refineries, terminals and at least some retail outlets in the affected areas appear to have fallen in the last week or so. We will also investigate why the prices have fallen in the way that they have.

I have committed the Federal Trade Commission to conduct a thorough, fair and objective study of gasoline price levels throughout the Midwest and, depending on what our investigation finds, to take appropriate action. Assuming the parties cooperate, I hope to have a status update on the progress of our investigation for the Congress by the end of July. Thank you, and of course I will be glad to answer questions.

[The prepared statement of Robert Pitofsky follows:]

PREPARED STATEMENT OF HON. ROBERT PITOFSKY,<sup>1</sup> CHAIRMAN, FEDERAL TRADE COMMISSION

#### I. INTRODUCTION

Mr. Chairman and members of the Committee, I am pleased to appear before you today at this hearing on the important topic of summer energy concerns, and to present the Federal Trade Commission's testimony, which will focus on recent increases in gasoline prices in certain Midwest markets. Competition in the energy sector—particularly in the petroleum industry—is vital to the health of the economy of the United States. Antitrust enforcement has an important role to play in ensuring that the industry is, and remains, competitive.

Consumers in some Midwest markets, such as Chicago and Milwaukee, have experienced considerable price increases in gasoline since early spring, and prices have continued to spike up in the past month. The national average retail price of reformulated gasoline ("RFG") increased from \$1.29 to \$1.67 per gallon from November, 1999 to June 12, 2000.<sup>2</sup> In Chicago, the average RFG price rose from \$1.85 per gallon on May 30 to \$2.13 on June 20.<sup>3</sup> From May 30 to June 20 in Milwaukee the increase was from \$1.74 to \$2.02.<sup>4</sup> During the week of June 19, RFG prices at some Chicago gas stations apparently rose as high as \$2.50, although they reportedly receded several cents towards the end of last week.<sup>5</sup>

Conventional gasoline prices in the Midwest have also risen substantially in recent weeks. National average retail prices increased from \$1.25 to \$1.61 per gallon for conventional gasoline between November, 1999 and June 12, 2000.<sup>6</sup> Average conventional gasoline retail prices in the Midwest rose from \$1.55 to \$1.85 per gallon from May 29 to June 19, 2000.<sup>7</sup> Increases as dramatic as those seen in recent weeks, without any obvious complete explanation, call for scrutiny by antitrust enforcement authorities to determine whether they result from collusion or other unlawful anti-competitive conduct.

The FTC is a law enforcement agency with two related missions: to preserve competition in the marketplace for the ultimate benefit of consumers and to protect consumers from deceptive or unfair practices that may injure them more directly. Unlike agencies that focus on particular industries, the Commission's statutory author-

<sup>1</sup> This written statement represents the views of the Federal Trade Commission. My oral presentation and response to questions are my own, and do not necessarily represent the views of the Commission or any other Commissioner.

<sup>2</sup> Energy Information Administration, Office of Oil and Gas Daily Price Report (June 12, 2000). In comparing average RFG prices at different times and at different places, it should be noted that RFG requirements may differ between summer and winter and also between localities.

<sup>3</sup> EPA Data, RFG-CG Price Information, based on Oil Price Information Service data (June 14, 2000, June 23, 2000).

<sup>4</sup> *Id.*

<sup>5</sup> See R. Kemper & K. Mellen, "As Pressure Builds, Price of Gas Falls," *Chicago Tribune* (June 23, 2000).

<sup>6</sup> EPA Data, RFG-CG Price Information (June 14, 2000).

<sup>7</sup> Energy Information Administration, Motor Gasoline Watch (June 21, 2000) at 2.

ity covers a broad spectrum of sectors in the American economy, including the energy industry and its various components. The Commission's Bureau of Competition shares responsibility for antitrust enforcement with the Antitrust Division of the Department of Justice. The Commission also shares its expertise in both competition and consumer protection matters by providing advice to the States and to other federal regulatory agencies.

Consumer welfare is the goal of antitrust enforcement across all industries. Its importance is particularly clear in the energy industry, where even small price increases can strain the budgets of many consumers, particularly those with low and fixed incomes, and of small business, and, as a result, can have a direct and lasting impact on the entire economy. In fiscal years 1999 and 2000 to date, the Bureau of Competition spent almost one-third of its total enforcement budget on investigations in energy industries.

Today, we provide an overview of our investigation into whether illegal conduct has led to gasoline price increases in Chicago, Milwaukee, and elsewhere in the Midwest.

## II. POTENTIAL CAUSES OF THE CURRENT PRICE SPIKES

Publicly available information suggests that several factors may have contributed to the recent spikes in prices. The first factor is the reduced global supply of crude oil. In the second half of 1999, OPEC countries, joined by several non-OPEC oil exporting countries, curtailed the global supply of crude oil. During the same time period, a number of Asian economies began to recover from a regional recession, causing increased demand for petroleum products. Moreover, in recent months, many foreign economies have experienced impressive growth, while the U.S. economy has continued its record expansion. The result is that worldwide consumption of crude oil has exceeded production, and world and U.S. inventories have been drawn down. Refiners responded to the crude price increases caused by this crude shortage by cutting gasoline production and using inventories of gasoline to meet demand, in the expectation that inventories could be replenished once crude oil prices dropped, with the result that the spread between crude oil and conventional gasoline increased. All of these factors have led to tight supply situations in many countries.

In the Spring of this year, the OPEC countries agreed to increase production in an attempt to moderate the price of crude petroleum, which had increased from a low of about \$12 a barrel in February 1999 to over \$32 a barrel in March 2000.<sup>8</sup> The announcement of the Spring supply increase caused crude prices to dip temporarily, but they have since recovered, reaching \$33 a barrel earlier this month, in the face of continued world-wide economic expansion and summer increases in demand for gasoline. It remains to be seen whether, when and to what extent OPEC's announcement last week of a further crude supply increase will reduce prices.<sup>9</sup>

Chicago, Milwaukee, and other places, principally in the Midwest, have suffered particularly severe recent price increases that cannot be explained solely by the OPEC actions and other world market factors, which would have an impact on all regions of the United States. One factor specific to the Midwest markets that may have contributed to the price increases was the introduction of EPA Phase II regulations for summer-blend reformulated gasoline that went into effect on May 1, 2000 at the wholesale level in both Chicago and Milwaukee. The new, more-stringent regulations require that winter-blend gas be drained from storage tanks before the summer-blend supply could be added. These regulations may have led to abnormally low inventories. According to some reports, summer-blend Phase II RFG is proving more difficult to refine than anticipated, causing refinery yields to be less than expected. The ethanol-based RFG used in Chicago and Milwaukee is reportedly proving to be the most difficult of all to make. Further, St. Louis has now entered the RFG program for the first time, thus adding additional demand to an already tight Midwest RFG supply situation.<sup>10</sup> Moreover, the recent appeals court decision upholding Unocal's patent for some formulations of RFG may have caused some refineries to change RFG blends in an effort to avoid infringement, leading to production delays and decreased refinery throughput.<sup>11</sup> As with the OPEC factor, RFG-related

<sup>8</sup>Energy Information Administration, Update: A Year of Volatility-Oil Markets and Gasoline, June 21, 2000 (West Texas Intermediate crude oil spot prices).

<sup>9</sup>On June 21, OPEC announced a production increase of 708,000 barrels per day. "OPEC Agrees to Increase Oil Production," *Wall Street Journal* (June 22, 2000) at A3.

<sup>10</sup>St. Louis received EPA waivers to delay implementation of Phase II RFG until early June, because of a break in the Explorer pipeline which serves the region. St. Louis uses primarily MTBE-based RFG, which many observers believe to be less costly than ethanol-based RFG. St. Louis has not so far experienced price increases as great as those in Chicago and Milwaukee.

<sup>11</sup>*Union Oil Co. v. Atlantic Richfield Co.*, 208 F.3d 989 (Fed. Cir. March 29, 2000).

issues seem unlikely, however, to provide a complete explanation for recent Midwestern gas price increases, given that in the Midwest as a whole, conventional gasoline prices have risen more dramatically than RFG prices since the end of May.<sup>12</sup>

Another possible factor underlying the price increases could be the break in the Explorer pipeline last March. This pipeline moves refined petroleum products from the Gulf of Mexico through St. Louis to Chicago and other parts of the Midwest.<sup>13</sup> Explorer is still not operating at full capacity.<sup>14</sup>

These supply and demand factors could explain the Midwest price increases in whole or in part. However, these price spikes are particularly large. None of these factors precludes the possibility that collusion may have occurred at some point that further contributed to higher gas prices for consumers. If non-collusive marketplace events do not explain the price spikes, that may provide circumstantial evidence that illegal activity has taken place. In addition, we may find more direct evidence. As we undertake this inquiry, we do not know what we will find.

### III. THE FTC'S INVESTIGATION

The Commission protects competition by enforcing the antitrust laws. We do not regulate or attempt to determine the reasonableness of energy prices. Instead, we investigate whether or not specific anticompetitive and unlawful conduct has occurred that interferes with the operation of the free market. Thus, our investigation will not determine whether prices are too high or too low, but only whether there is reason to believe that the antitrust laws have been broken.

For analytical purposes, it is best to think of the Commission's antitrust enforcement authority as divided into merger and nonmerger sectors. Enforcing the law against anticompetitive mergers prevents the accumulation of unlawful market power, that is, the ability profitably to raise prices above competitive levels. The matter we are discussing today involves enforcing the nonmerger provisions of the antitrust laws. There are two principal types of nonmerger conduct that may have unlawful anticompetitive effects: (1) the illegal acquisition or maintenance of monopoly power, which typically consists of a single firm's exclusionary conduct to prevent or impede competition; and (2) collusion among two or more independent firms to increase prices, curtail output or divide markets. Our investigation will focus on whether any industry participants have engaged in collusion because it does not appear, at the outset, that any single oil company has sufficient market power to raise prices unilaterally.

The Commission has initiated a formal investigation into the causes of the recent gas price increases in the Midwest. This will be a civil investigation conducted pursuant to our authority under the Federal Trade Commission Act.<sup>15</sup> The investigation is being spearheaded by our Midwest Regional Office, located in Chicago. We are working closely with the Attorneys General of the affected States to coordinate our combined efforts.

The Commission's investigative process in a nonmerger collusive practices case involves a thorough search for evidence that the industry participants are engaging, or have engaged, in collusive behavior prohibited by the antitrust laws. Once a formal investigation is opened, staff typically requests from the Commission the authority to use compulsory process. The Commission has approved the use of compulsory process in this investigation, permitting the issuance of both subpoenas and Civil Investigative Demands, and the taking of depositions under oath.<sup>16</sup> Process will be used to take testimony and gather evidence from the various entities that

<sup>12</sup> According to Energy Information Administration figures, average retail prices throughout PADD II (the Midwestern Petroleum Administration for Defense District) rose 18.9 cents for RFG and 29.4 cents for conventional gasoline from May 29 to June 19. See Energy Information Administration, Motor Gasoline Watch (June 21, 2000) at 2.

<sup>13</sup> Environment News Service, "Gasoline Spill Threatens Dallas Water Supply" (March 13, 2000).

<sup>14</sup> EPA/DOE briefing of results of field interviews to FTC staff, 6/14/2000 and to Midwest/Northeast Congressional Caucus, 6/16/2000.

<sup>15</sup> 15 U.S.C. § 41 et seq. The Commission does not have criminal enforcement authority. The Antitrust Division of the Department of Justice has exclusive responsibility for criminal enforcement of the antitrust laws, pursuant to authority granted under the Sherman Act. 15 U.S.C. § 1 et seq. If we uncover evidence of criminal activity, however, such as hard-core price fixing, we can forward the matter to the Antitrust Division.

<sup>16</sup> Subpoenas and CIDs are two methods of requiring the submission of certain information needed for an investigation. The Commission has authority to issue both. There are certain administrative and procedural advantages to each type of compulsory authority. Subpoenas are generally preferable for document discovery or in-person testimony, while CIDs may be superior for obtaining interrogatory responses or information and for service on foreign entities. Naturally, the Commission seeks evidence from witnesses on a voluntary basis where appropriate or feasible.

refine, transport and distribute gasoline in the Midwest, as well as suppliers and customers, and other knowledgeable or affected persons. The Commission already has begun issuing subpoenas to the entities involved in the chain of gas supply to the affected region. These entities include refiners, pipeline owners and operators, terminal owners and operators, and blend plant owners and operators. Our staff also has begun conducting interviews with market participants, consumers, corporate users of gasoline, and others with potential knowledge of relevant facts. The objective is to determine who raised prices, and whether there was any illegal contact, communication or signaling among competitors before or during the time of the price increases.

The Commission must show more than parallel behavior among market participants to prove collusion. The fact that all companies raise prices at the same time is not sufficient evidence of collusion. The courts have held that some "plus factor" must be present to demonstrate that an agreement was reached. Behavior that would be unprofitable "but for" collusion may be evidence that such an agreement exists.

Beyond this general description of what the Commission is undertaking, we can make no further comment about the particulars of this on-going, non-public investigation. We must emphasize that an FTC antitrust investigation is not a quick fix. The Commission will provide an interim status report by the end of July, but it may take significantly longer than that to conduct the thorough investigation that this matter deserves. Our objective is to determine whether there has been any illegal conduct, and, if there has, to determine who was responsible and either bring the matter to court or initiate our own administrative proceeding. We need to develop solid documentary and testimonial evidence in order to be able to bring a case. Based on the FTC's extensive experience in conducting these kinds of investigations, we know this can be done only through a careful and fact-intensive analysis. We cannot say at this time when the investigation will be concluded.

We assure you that our investigation will be thorough, objective and as expeditious as possible. The FTC has an excellent staff of lawyers and economists with considerable experience in the oil industry who are working on this investigation, and we will pursue this matter vigorously.

Chairman BLILEY. Thank you, Mr. Pitofsky.  
Ms. Browner.

**STATEMENT OF HON. CAROL M. BROWNER, ADMINISTRATOR,  
ENVIRONMENTAL PROTECTION AGENCY**

Ms. BROWNER. Thank you, Mr. Chairman and members of the committee. We appreciate the opportunity to appear today. We are here today because we share your concern about the gasoline prices, particularly in the Chicago-Milwaukee areas. Consumers in those markets are entitled to the very same benefits received by other Americans. They deserve fair market prices at the pump, and they deserve cleaner, healthy air. There literally is no good reason why consumers in Chicago and Milwaukee cannot have both.

Nationwide, regular gasoline is selling on average at \$1.65 per gallon. The cleaner burning gasoline, excluding the Chicago and Milwaukee areas, is selling at \$1.64 per gallon, a penny less than conventional gasoline. Approximately 30 percent of the gasoline sold in the United States is cleaner burning gasoline, and on average as of today it is selling for less than conventional gasoline. Even in Chicago the wholesale price for cleaner burning gasoline is less than the wholesale price for conventional gasoline in nearby markets.

On June 15, after an investigation by EPA and DOE staff, an investigation of supply issues relating to the high prices in Chicago and Milwaukee, an investigation that produced no good explanation from the oil companies serving these areas, Secretary Richardson and I asked the Federal Trade Commission to officially launch its own investigation. From the moment word of our letter



to the FTC reached the press, and maybe this is coincidence, but maybe not, wholesale prices began to decline precipitously. Prices have fallen from a high of \$1.60 per gallon wholesale at the time we issued our letter to \$1.20 per gallon wholesale today.

We hope that retail prices at the pump will follow the downward trend. And there has been some good news about retail prices starting to decline. Since Monday we have seen a drop of retail prices on the order of Chicago, 9 cents per gallon; Milwaukee, 10 cents per gallon; but the consumers are not seeing the full effect of these changes at the pump despite the drop in wholesale prices, almost a 40-cent drop in wholesale prices.

Mr. Chairman, I am sure that all of us in this room today are very, very troubled by this situation, and we believe that the oil companies who serve these markets still owe you, but, most importantly, the people of this region, an explanation. We know from our review that throughout June and before June, supplies of cleaner gasoline in the region have been adequate. Terminals where the cleaner gasoline is stored for delivery to the pump have contained ample supply. There are 650,000 more barrels of cleaner gasoline in the Chicago-Milwaukee area this June than there were last June. We also know from our review that throughout June the pipelines and other distribution systems for getting the gas to Chicago and Milwaukee have been able to handle the full demand for moving gasoline from the oil companies. Since mid-March, the Explorer pipeline from Houston to Tulsa has been running at 90 percent capacity. North of Tulsa it is at 100 percent of capacity.

Finally, we know that the cost of producing cleaner gasoline is 4 to 8 cents more per gallon, and that the preference of Midwestern States—this is their preference and not mandated by Congress or the EPA, to use ethanol as an additive only adds very marginally to that very small increase.

I want to be clear. This administration strongly supports the use of ethanol as an oxygenate in gasoline. Ethanol has been used for years. This is not a new additive. It has been part of our gasoline supply in this country for the better part of a decade, and it has been used very, very successfully.

In 1990, Congress passed the Clean Air Act, the new revised Clean Air Act, and in that act Congress mandated the cleaner burning gasoline nearly unanimously. Congress voted in support of a congressional requirement that the most polluted cities be required to sell cleaner gasoline. The oil companies were put on notice in 1990 that they would be selling cleaner gasoline in certain regions of the country. EPA entered into a 6-month process with the oil companies in 1993 as to what the specifics of that cleaner gasoline recipe would be. We reached a final agreement with the oil companies 7 years ago as to what kind of gasoline, the recipe for cleaner gasoline, that they would be required to deliver to consumers June 1 of this year; 7 years' notice to the oil companies of what they were required to do.

The Federal Trade Commission, I assume, and from the words of the Chairman who joins us here today, does not take investigations lightly, and as we understand, as the FTC stated before launching its formal investigation that it, too, could find no explanation for the price spikes that plagued the people of region. That is why we

believe that they have honored their request to find out what is behind these price spikes.

In recent weeks EPA has received some requests to waive the cleaner burning gasoline program. Let me assure you that we take these requests very, very seriously, and let me also assure you that we leave all options on the table while we continue to monitor gasoline supplies. Our first commitment is to bring fair prices at the pump to the people of the Midwest, particularly Chicago-Milwaukee areas. That is why waivers must be applied responsibly. Since supplies of cleaner burning gasoline already are in the system, they are in the pipeline, they are in the terminals, they are in the tanks, the trucks, since they are already in the system, the granting of waivers actually could send the cost of gasoline back upwards, yet again we could see gasoline prices in the Midwest rising.

Since the cleaner burning gasoline program began 5 years ago—this is the second phase of the program, the first phase actually began 5 years ago—it has resulted in annual reductions of 105,000 tons of smog-forming pollutants and 24,000 tons of toxic air pollutants. This is equivalent to eliminating the smog-forming pollution generated by 16 million cars. As a result of this program, the health of tens of thousands of people is being protected every summer from respiratory disorders, particularly children who are very, very vulnerable to asthma attacks. That is why we want to make sure that the people of Chicago, the people of Milwaukee receive fair treatment both at the pumps—

Chairman BLILEY. Could you summarize?

Ms. BROWNER. [continuing] and in terms of receiving the full protection of their health from air pollution. People in many other markets throughout the U.S. are receiving these benefits. We believe the people of Chicago and Milwaukee deserve the same.

We know that cleaner burning gasoline is not the problem. We know that ethanol is not the problem. We are grateful that prices at the pump seem to be dropping, but we still deserve an adequate explanation from the oil companies that serve Chicago and Milwaukee about why prices there have been so high. Thank you.

[The prepared statement of Hon. Carol M. Browner follows:]

PREPARED STATEMENT OF HON. CAROL M. BROWNER, ADMINISTRATOR, U.S.  
ENVIRONMENTAL PROTECTION AGENCY

Thank you, Mr. Chairman and Members of the Committee, for the invitation to appear here today. I appreciate having the opportunity to share what we know about the recent sharp increases in gasoline prices, particularly in the Midwestern part of the country. I also will explain the Environmental Protection Agency's efforts, in coordination with the Department of Energy and the Federal Trade Commission, to address the situation.

Mr. Chairman, first and foremost we are very concerned that consumers receive the air quality benefits of the clean burning gasoline (also called reformulated gasoline, or RFG) program at a fair and reasonable price. In the following testimony I will show that the cost of producing RFG does not account for the extremely high price differentials we have seen in the Chicago and Milwaukee areas. As EPA reviewed the various requests for waivers from the RFG program, factors such as the pipeline, tank turnover and patents were examined. We do not believe that these factors adequately explain the price differentials that we have seen in the Chicago and Milwaukee areas.

Let me begin with a history of the RFG program.

### *History of RFG*

When Congress passed the Clean Air Act Amendments of 1990 it put in place a number of programs to achieve cleaner motor vehicles and cleaner fuels. These programs have been highly successful in protecting public health by reducing harmful exhaust from the tailpipes of motor vehicles. In the 1990 Amendments, Congress struck a balance between vehicle and fuel emission control programs after extensive deliberation. The RFG program was designed to serve multiple national goals, including air quality improvement, enhanced energy security by extending the gasoline supply through the use of oxygenates, and encouraging the use of domestically-produced, renewable energy sources.

Congress established the overall requirements of the RFG program by identifying the specific cities in which the fuel would be required, specific performance standards, and an oxygenate requirement. The oil industry, states, oxygenate producers and other stakeholders were involved in the development of the RFG regulations in 1991 through a successful regulatory negotiation. EPA published the final regulations establishing the detailed requirements of the two-phase program in early 1994. Thus, the oil companies and other fuel providers have had six years to prepare for the second phase of the program that began this year. In addition, the oil industry has been involved in an EPA RFG implementation advisory workgroup since 1997 and at no time during those discussions did the companies raise concerns about production, supply or distribution problems that might occur.

The first phase of the federal reformulated gasoline program introduced cleaner gasoline in January 1995 primarily to help reduce vehicle emissions that cause ozone (smog) and toxic pollution in our cities. Unhealthy smog levels are a significant concern in this country, with over 100 million people living in 36 areas currently violating the 1-hour ozone standard.

The federal RFG program is required by Congress in ten metropolitan areas which have the most serious air pollution levels. Although not required to participate, some areas in the Northeast, in Kentucky, Texas and Missouri have elected to join, or "opt-in" to the RFG program as a cost-effective measure to help combat their air pollution problems. At this time, approximately 30 percent of this country's gasoline consumption is cleaner-burning reformulated gasoline.

The Clean Air Act Amendments of 1990 also required that RFG contain 2.0 percent minimum oxygen content by weight. Neither the Clean Air Act nor EPA requires the use of any specific oxygenate. Both ethanol and MTBE are used in the current RFG program, with fuel providers choosing to use MTBE in about 87 percent of the RFG. Ethanol, however, is used exclusively in RFG in the upper Midwest (Chicago and Milwaukee).

Ambient monitoring data from the first year of the RFG program (1995) confirm that RFG is working. RFG areas showed significant decreases in vehicle-related tailpipe emissions. One of the air toxics controlled by RFG is benzene, a known human carcinogen. The benzene level at air monitors in 1995, in RFG areas, showed the most dramatic declines, with a median reduction of 38 percent from the previous year. The emission reductions which can be attributed to the RFG program are the equivalent of taking 16 million cars off the road. About 75 million people are breathing cleaner air because of cleaner burning gasoline. Since the RFG program began five years ago, it has resulted in annual reductions of smog-forming pollutants of at least 105 thousand tons, and toxic air pollutants by at least 24,000 tons.

As required by the Clean Air Act, the first phase of the RFG program began in 1995 and the second phase began in January of this year. As an example of the benefits, in Chicago, EPA estimates that the Phase II RFG program will result in annual reductions of 8,000 tons of smog-forming pollutants and 2,000 tons of toxic vehicle emissions, benefitting almost 8 million citizens in the Chicago area facing some of the worst smog pollution in the nation. This is equivalent to eliminating the emissions from 1.2 million cars in Illinois.

### *Administration Response to Increasing Prices*

In early June, as gasoline prices rose, particularly in the Midwest, EPA and DOE invited Midwest oil refiners to a meeting in Washington, DC. Simultaneously, EPA, DOE and the Energy Information Agency (EIA) sent two teams of technical experts to the Midwest to investigate the situation and to talk to refiners, distributors, pipelines, jobbers, terminal operators and retail outlets. Following those meetings, which occurred on June 12 and 13, EPA Administrator Browner and DOE Secretary Richardson sent a joint letter on June 15 to Chairman Pitofsky requesting that the Federal Trade Commission conduct a full and expedited formal investigation into the pricing of RFG in Chicago and Milwaukee.

Since June 15, the wholesale price of reformulated gasoline has dropped by over 38 cents per gallon in Chicago and Milwaukee. The Oil Price Information Systems

(OPIS) has reported that the wholesale price differential between RFG and conventional gasoline in nearby cities has dropped to less than 1 cent a gallon in Chicago and 8 cents a gallon at Milwaukee terminals.

In our discussions, representatives of oil companies listed a number of factors which they believed contributed to the price differential between RFG and conventional gasoline in the Midwest. These included: the additional cost of producing RFG phase II, temporary shutdown of the Explorer Pipeline, the difficulty with replacing winter gas with summer blends (draining tanks), and the Unocal patent. I would now like to discuss each of these factors and show why EPA believes even taken together they do not account for the high gasoline prices.

#### *Production Costs for RFG Do Not Explain Price Increases*

As I stated earlier, we are very concerned that consumers receive the benefits of the RFG program at a fair price. Across the country hundreds of communities are benefitting from RFG II for pennies per gallon. In fact, this Monday (June 26), the average retail price of conventional gasoline across the country was \$1.65 per gallon. EPA has calculated, based on EIA and OPIS surveys, that the average retail price for RFG II everywhere except in Chicago and Milwaukee was \$1.64 per gallon, while the average retail price in Chicago and Milwaukee was \$2.08 per gallon.

EPA strongly disagrees that the RFG program is responsible for increases in gasoline prices in the Midwest. In fact, EPA's estimates of the average cost for the production of Phase II RFG range from 4 to 8 cents more per gallon than conventional gasoline (with the use of either ethanol or other oxygenates). Several studies agree with EPA's estimates of the average costs:

Analysis by Bonner and Moore Management Science, a nationally recognized firm that specializes in refinery cost analysis, estimated that RFG I would add 3-5 cents more per gallon to the average cost compared to conventional gasoline. Subsequent studies by Bonner and Moore and Oak Ridge National Laboratory estimated that RFG II would add 1-2 cents to the average cost of RFG I or 4-7 cents to the average cost of conventional gasoline. Oak Ridge National Laboratory estimated that the average added cost of blending ethanol into RFG II as compared to RFG I was about 1 cent more per gallon.

As I have already stated, over the past week, the wholesale price differential between RFG and CG has dropped dramatically in the Chicago/Milwaukee area. We do know that this differential is now in line with differentials observed in other parts of the country. EPA does not believe that the cost of complying with RFG regulations accounts for the extremely high price differentials we have seen in the Chicago-Milwaukee areas.

#### *Temporary Shutdown of Explorer Pipeline*

EPA investigated the situation with the Explorer pipeline to respond to the waiver requests we received and would like to share our findings. The Explorer pipeline has historically provided 10 to 15 percent of the RFG supply for the Chicago/Milwaukee area. The outage of the pipeline in mid-March meant a loss of 108,000 barrels of RFG destined for the Chicago area. Chicago consumes about 200,000 barrels of gasoline a day. Thus, the RFG lost due to the Explorer pipeline outage was less than one day's RFG needs for Chicago. Since mid-March, the Explorer pipeline from Houston to Tulsa has been running at 90 percent capacity, while the pipeline north of Tulsa to the Midwest has been capable of operating at 100 percent capacity. The supply of RFG to the Midwest has increased this year over last year and, in fact, for the month of June refiners expected to supply 650,000 more barrels of RFG this year than last year. The Explorer pipeline has informed us that more RFG could be sent if the companies elected to do so. For example, the pipeline company has informed us that, beginning earlier this month deliveries of RFG to Chicago have increased by approximately 100,000 barrels per ten day cycle.

#### *Tank Turnover*

Tank turnover refers to the need to replace winter gasoline in terminal storage tanks with summer blends. Fuel providers have been doing this for over ten years to comply with summertime gasoline volatility requirements. This normally begins in April and, as required by regulation, the tanks at terminals must all meet summertime RFG requirements as of May 1st.

#### *Unocal Patent*

EPA has heard comments as to the impact of the Unocal patent. While we understand that this matter may be in litigation, the refiners have told us in meetings with them that they are able to produce RFG that is not subject to the patent. In our discussions with refiners and with Unocal, no one has identified any cost or sup-

ply issues related to the patent that could in any way explain the price increases for RFG that we have seen in the Midwest over the last two months.

#### *Waiver Issues*

In recent weeks there have been many calls for EPA to waive the RFG Phase II requirements in Milwaukee and Chicago. The RFG regulations provide for an administrative waiver under very limited circumstances—extreme and unusual circumstances, such as Acts of God or natural disaster, where the refiner or importer is unable to comply with the RFG requirements despite their exercise of due diligence and planning. The various criteria for an administrative waiver under the regulations have not been met in the Milwaukee or Chicago area, so EPA has treated all of the requests for a waiver as requests for enforcement discretion. Enforcement discretion is normally used in situations such as occurred in St. Louis early this spring, where the short term shut down of the Explorer pipeline led to actual and acute shortages. The pipeline supplies on average 70 percent of fuel delivered to St. Louis.

For Chicago and Milwaukee the supply of RFG continues to be adequate and prices are going down. All refiners have strongly recommended that EPA not grant RFG waivers. It is highly uncertain what effect a waiver would have on supply and prices. Refiners would need to make adjustments and switch gears, imposing short term costs and the possibility of supply problems. No RFG Phase I is currently available, and supplies of conventional gasoline are tight as well. Waiving the RFG Phase II requirements under these kinds of circumstances could exacerbate the supply and price situation in the Midwest, for both RFG and conventional gasoline.

#### *Conclusion*

In closing, I would like to reiterate the following points:

- Clean burning RFG II is providing public health benefits to almost 75 million citizens nationally and nearly 8 million in the Chicago area alone.
- EPA believes the cost of producing RFG II does not account for the extreme prices being paid by Midwest consumers. The pipeline disruption, the tankage issue, the Unocal patent and its implications, as well as ethanol use, have all been analyzed. EPA does not believe that these factors adequately explain the price increases we have seen in recent weeks.
- We are concerned that consumers are paying these high prices for RFG II.

This concludes my prepared statement. I would be pleased to answer any questions that you may have.

Chairman BLILEY. Thank you.  
Secretary Slater.

#### **STATEMENT OF HON. RODNEY E. SLATER, SECRETARY OF TRANSPORTATION, DEPARTMENT OF TRANSPORTATION**

Mr. SLATER. Mr. Chairman, members of the committee, I am pleased to join Secretary Richardson, Administrator Browner, and Chairman Pitofsky here today. I personally am pleased to have the opportunity to provide to the committee information regarding the status of our efforts at the U.S. Department of Transportation to ensure the safe and efficient transport of motor fuels to consumers nationwide. The administration is fully committed to a sound, comprehensive approach to energy policy across the Federal Government. We are prepared to take whatever steps are necessary to promote a sound energy policy that keeps transportation moving and our economy growing.

Just yesterday the President announced good news regarding our Nation's strong economy, a budget surplus of more than \$211 billion this year and a projected surplus over the next 10 years that will be over \$1 trillion more, larger than the forecasts just 4 months ago. President Clinton, working with this Congress and the American people, has set a new economic course of fiscal discipline, expanded trade, greater investment in our people and in our future, and clearly, transportation and the fuels concerns that we are

here to discuss today will have an impact on this overall question. Our efforts to date, though, have produced the longest economic expansion in our Nation's history. Our commitment is to continue that.

At the U.S. Department of Transportation we have a transportation policy with energy security as an essential component. It is balanced by an approach that recognizes our role in regulating the transport of resources and influencing the aggregate demand by transportation users. One element of regulating the transport of energy resources is ensuring the safe, reliable, and environmentally sound operation of the Nation's pipeline transportation system, including more than 150,000 miles of pipelines that transport 60 percent of the crude oil and petroleum products consumed nationally.

I can assure you, Mr. Chairman and members of the committee, that our pipeline restrictions have not significantly affected the supply of gasoline in the Midwest. To ensure, though, the safe operation and enforcement of our regulations covering the design, construction and inspection, testing and operation, and the maintenance of our pipelines is a top concern of the Department and this administration.

We achieve compliance with our regulations through our own programs, and we work in partnership with State agencies to oversee intrastate pipelines. The administration introduced, as you know, the most comprehensive pipeline safety bill ever produced in the country. It is now before the committee and the Congress, and we thank you for your support and consideration of this measure. We are hopeful that we will have it as a matter of law by the end of this congressional session.

The Research and Special Programs Administration is keeping close watch on two gasoline transmission pipelines in particular, which are currently operating at a 20 percent pressure reduction because of potential problems with pipeline integrity as corrective efforts are pursued. These are the Wolverine pipeline operating between the Chicago area and Detroit and the Explorer pipeline serving St. Louis and Chicago. If I may, Mr. Chairman, I would like to give a little information about the current status of both of those pipelines.

The Wolverine pipeline failed June 7, releasing some 1,700 barrels of gasoline. The operator has reduced operating pressure by 20 percent until it can check the welds of the pipeline. We anticipate that the operator will complete this work and resume normal operations within 3 weeks. Operating at reduced pressure, however, Wolverine is currently meeting the prefailure level of demand in the eastern part of Michigan, and I underscore that. Supply in the western part of the State was not affected. Again, any restrictions here have not affected service in the Midwest.

As relates to Explorer, the pipeline failed on March 7 in Texas, releasing approximately 12,000 barrels of gasoline due to failure in a longitudinal seam. The operator reduced the operating pressure by 20 percent and developed a plan to address the safety issues that may have played a role in the failure. Although the Explorer pipeline continues to operate at a 20 percent reduction in operating pressure, the addition of drag-reducing agents to the products in

the pipeline has enabled the operator to maintain most of its normal volume despite the pressure reduction.

Again, there is no evidence that either of these pipelines, although they have reduced pressure, have not been able to meet the needs of the American people and especially in the Midwest. The Explorer company reports that its shippers' tanks in the St. Louis area are at capacity, and that it is meeting the shippers' demand for reformulated gasoline as well. This means that the 20 percent pressure reduction has minimal impact on the supply of petroleum products at Chicago and other Midwest points.

Mr. Chairman, I would like to close by saying while I have addressed specifically the issue of these pipelines, we would like to just underscore the fact that we have a very comprehensive transportation program dealing with energy efficiency. I work with the automobile industry to produce new generation vehicles. I work with Amtrak under the leadership of Governor Tommy Thompson and former Governor Mike Dukakis to bring intercity high-speed rail service not only to the Northeast corridor, but across the country. I have worked with the trucking industry to deal with midsize and heavy-duty trucks to provide 21st century truck capacity and fuel efficiency in the future as well. We are also working with the Congress to promote certain provisions in our administration's bill that will allow us to invest even more in transit and intercity rail and fuel-efficient vehicles.

I would like to close with the fact that last year for the first time in more than four decades, we actually saw significant usage of transit by the American people, some 9 billion passengers. We believe that this provides a significant alternative to single-occupancy vehicle use in the country. Again, it represents a comprehensive approach to fuel efficiency and dealing with the security needs of the Nation.

With that, Mr. Chairman, I join my colleagues in being ready, willing and able to respond to any questions that you and other members of the committee might have.

[The prepared statement of Hon. Rodney E. Slater follows:]

PREPARED STATEMENT OF HON. RODNEY E. SLATER, SECRETARY OF TRANSPORTATION

Mr. Chairman, Mr. Dingell, and Members of the Committee: I am pleased to join Secretary Richardson, Administrator Browner, and Chairman Pitofsky here today to provide the Committee with the status of our efforts at the Department of Transportation to provide for the safe and efficient transportation of motor fuels to consumers nationwide. The Administration is fully committed to a sound, comprehensive approach to energy policy across the federal government, and I would like to lay out the short-term and longer-term initiatives we are undertaking at the Department of Transportation.

Focusing first on the retail supply of gasoline, we at DOT are responsible for regulating the safe, reliable, and environmentally sound operation of the nation's pipeline transportation system, including more than 150,000 miles of pipelines that transport 60 percent of the crude oil and petroleum products consumed nationally.

To provide for the safe operation of this vast transportation network, the Department's Research and Special Programs Administration enforces regulations covering the design, construction, inspection, testing, operation, and maintenance of pipeline systems. We achieve compliance with our regulations through a partnership with state agencies, which not only oversee intrastate pipelines, but also participate with the federal government in addressing issues of local concern involving interstate pipelines.

Just one year ago, on June 10, a terrible tragedy struck Bellingham, Washington, when an interstate gasoline pipeline ruptured, resulting in the deaths of three

young people. Safety is our highest priority at the Department, and we are working now with Congress to expand our safety authority for regulating hazardous liquid pipelines. Early last year, your Committee reported a bill to the House to reauthorize the pipeline safety program. In April, the Administration transmitted its comprehensive legislation to reauthorize and strengthen the Department's pipeline safety program. The Senate Committee on Commerce, Science, and Transportation recently reported a bill to address public awareness, enforcement, environmental protection, and federal-state partnerships to accomplish our goals. We look forward to working with you to achieve passage of a reauthorization bill in the 106th Congress.

The Research and Special Programs Administration is keeping a close watch on two gasoline transmission pipelines, which are currently operating at a 20% pressure reduction because of potential problems with pipeline integrity, as corrective efforts are pursued. These are the Wolverine Pipeline operating between the Chicago area and Detroit, and the Explorer Pipeline serving St. Louis and Chicago.

On June 7, the Wolverine Pipeline failed in Jackson, Michigan, releasing 1,700 barrels of gasoline. The pipeline was out of service for several days for initial clean-up, investigation, and repair. The failure appeared to be caused by a defective weld on a fitting and the operator has reduced operating pressure by 20% until it can check welds on similar fittings on the pipeline. We anticipate that the operator will complete this work and resume normal pressure within three weeks.

Operating at the reduced pressure, Wolverine is currently meeting the pre-failure level of demand in the eastern part of Michigan, but could not make up for the demand that was unmet during the few days it was out of service. Supply in the western part of the State is unaffected. It should be noted that Michigan does not participate in the Clean-Burning Gasoline (or RFG) program.

On March 9, an Explorer pipeline failed near Greenville, Texas, releasing approximately 12,000 barrels of gasoline. The failure—in a longitudinal seam—may have resulted from a systemic defect in the pipeline. The operator reduced the operating pressure by 20 percent and developed a plan to address the safety issues that may have played a role in the failure.

The operator's plan to address safety issues includes internal inspection of the pipe with an inspection tool that is designed to detect seam defects. The inspection has been done and the operator expects to have preliminary analysis of the data on the seams done in early July and full analysis completed by the beginning of September. The operator is also reviewing the corrosion prevention provided for the pipeline. Although the pipeline continues to operate at a 20% reduction in operating pressure, the addition of drag reducing agents to the products in the pipeline has enabled the operator to maintain most of its normal volume despite the pressure reduction. Further, the company reports that its shippers' tanks in the St. Louis area are at capacity and that it is meeting the shippers' demands for reformulated gasoline. This means that the 20% pressure reduction has minimal impact on the supply of product that Explorer can deliver in the areas north of Tulsa, including Chicago and other Midwest points.

I would like to address two other areas of potential concern. The U.S. Coast Guard is actively monitoring both the Lake Charles, Louisiana, and Port Houston, Texas, ship channels over concerns that sunken barges or platforms may be interfering with crude oil shipments to refineries located there. In fact, the sinkings have not significantly interfered with shipping since they occurred and were marked.

Some have suggested that the "Hours of Service" limitations should be suspended on the number of hours fuel delivery truck drivers can work. Our authority in this area is strictly limited to emergencies, such as a major snowstorm. Based on our analysis to date, we have not found that a shortage of drivers is a significant factor in supplying fuel.

The pressure on motor fuel prices should allow us to focus better on the long-term initiatives that can assure our nation's energy security. In the case of my Department, I must emphasize to this Committee, which played a key role in enacting the Corporate Average Fuel Economy statutory requirement in 1975, the energy security risks of continuing the current prohibition Congress has placed on our ability to fully analyze CAFE levels and options for increased fleet economy. The fuel economy of the automobile fleet has increased more than 50 percent since CAFE standards were put in place, reducing our dependence on foreign oil and saving billions of gallons of oil and billions of dollars for the consumer. Striking the newest prohibition, contained in the House version of the FY2001 Appropriations Bill, would signal a new chapter in U.S. resolve to promote fuel efficiency and save U.S. households hundreds of dollars each year.

Our Department, the Department of Energy, and the Environmental Protection Agency are pursuing the technological advances in automobile propulsion that will usher in a new generation of passenger motor vehicles that will consume much less



fuel and produce significantly less pollution than current internal combustion engines. We urge Congress to fully fund these programs. In addition, the Congestion Mitigation and Air Quality Improvement Program (CMAQ) continues to fund a wide variety of transportation improvement projects—such as Intelligent Transportation Systems, new transit, bicycle and pedestrian improvements, and alternative fuel projects—that will reduce fuel consumption and congestion and improve air quality, thus having a positive impact on the quality of life. The Clean Fuels program established in the Transportation Equity Act for the 21st Century has never been implemented because in both FY99 and FY00, the appropriations acts transferred the funds to and earmarked the funds for the Capital Bus program. The Department is prepared to implement the program and has initiated rulemaking.

We have before Congress a proposal for use of unanticipated fuel excise taxes, the so-called RABA dividend, that would boost transit and intercity passenger rail use. Both of these alternative modes of travel can reduce passenger vehicle miles and take pressure off gasoline supplies. I urge Congress to include these options in their deliberations about the current situation in the Midwest, and in setting longer-term energy policy for our great nation.

In conclusion, I want to assure the Committee that the Department of Transportation remains committed to ensuring a safe transportation system that meets our national interests and enhances the quality of life for the American people, today and in the future.

I would be pleased to join my colleagues in answering any questions the Committee Members may have.

Chairman BLILEY. Thank you, Secretary.

Now it is a pleasure to welcome an alumnus of this committee, the star of the Democrat baseball team for years, to bat cleanup for the administration.

#### **STATEMENT OF HON. BILL RICHARDSON, SECRETARY OF ENERGY, DEPARTMENT OF ENERGY**

Mr. RICHARDSON. Thank you. It is good to be back and join Chairman Pitofsky, Secretary Browner and Secretary Slater and to see my friends again.

Mr. Chairman, our energy policy is based on the following principles. First, market forces, not artificial pricing; second, diversity of supply and strong diplomatic relations with energy-producing countries; third, improving the production and use of traditional fuels through new technology development; fourth, diversity of energy sources with long-term investment in alternative fuels and energy sources; fifth, increasing efficiency in the way that we use energy; and last, maintaining and strengthening our insurance policy against supply disruptions, and that is adequate management of the Strategic Petroleum Reserve.

We are seeing some good signs in our oil and gas markets thanks to the adherence to this policy that I believe Administrator Browner mentioned, and I am pleased to report that the Energy Department's Energy Information Administration reports that conventional regular gasoline prices have dropped 3 cents per gallon over the past week nationwide; and in the Midwest, where we have expressed concern about very high prices, the Agency reports a drop of 7 cents per gallon for conventional regular. Reformulated gas is down 12 cents a gallon in the Midwest.

This is encouraging news. Nonetheless these prices are still unacceptably high, and hopefully they signal a trend, but time will tell.

Part of the relief is coming from work that we have done over the past 6 months when we moved aggressively to help improve supply. I have talked with the oil-producing nations. OPEC has

heard our concerns and have twice increased oil production. Right now there are roughly 3.5 million barrels per day more oil on the market than this time last year. That is meaningful. As the supply and demand move toward equilibrium over the next few months, we will see downward pressure on prices.

So we have had some success, but we need to find more lasting solutions because right now we are still encountering very low stocks and soaring demand. We want stability in prices and, therefore, are best served by adhering to our energy policy. The President has looked to do so, rolling out proposals to increase domestic production, spur energy efficiency, and increase the use of alternative energy sources. You will recall that we had a heating oil shortfall, and in response the President released almost a third of a billion dollars in funds so that low-income individuals could pay their heating bills. He asked for \$600 million more in low-income housing energy assistance funds, and the President is seeking an additional \$19 million from Congress in low-income home weatherization.

We address the issue of supply through increased support for tankers, small business loans for distributors and other small businesses impacted by high prices, and encourage refiners to increase production. We are also seeking to turn around domestic production of oil, develop alternative sources of energy and increase energy efficiency. We are also looking to help independent oil producers test new production technologies, lend a hand to small producers in existing fields, develop some tax credits in G&G expensing marginal wells to help those independent producers. We are helping refiners deal with the new EPA rules through our Ultraclean Fuels Program. We have established at the Department an Office of Energy Emergencies to coordinate with States and other Federal agencies regarding any energy-related crises.

Still, demand remains very high, the highest ever for this time of the year. Refineries in the U.S. are operating at 96 percent utilization, 99 percent in the Midwest, so I don't think that the production boosts are going to immediately push prices lower, but I think in time we will see the price pressure ease a bit.

The Administrator has talked about our concern for gasoline prices in the Midwest and Chicago and Milwaukee. Our experts are talking to EPA, and we are coordinating our efforts to bring relief to consumers, and we all know about Chairman Pitofsky's investigation, which I think is key to answering some of the lingering questions, his investigation of pricing practices in the region.

Mr. Chairman, as I conclude, let me just mention other steps that we have taken in the past 2 weeks to meet some unexpected issues. On June 15 I ordered a limited exchange of crude oil from the Strategic Petroleum Reserve's West Hackberry site, the two refineries, after a commercial dry dock collapsed near Lake Charles, Louisiana, and shows our commitment to responding quickly. The Army Corps of Engineers has worked over time to dredge a new canal, and oil traffic is moving again. And when there was a pipeline problem near St. Louis, as the Secretary and the Administrator mentioned, the EPA granted a waiver that postponed implementation of their new rule on reformulated gasoline until the problem was solved.

There is a lot we can do together in a bipartisan fashion, Mr. Chairman, as we move ahead in the crucial days of the Congress of the President's \$4 billion tax package of tax incentives for supporting the domestic oil industry, for renewable energy, for purchasing more efficient cars, homes and consumer products. We need to increase our Federal investment in domestic sources of energy, particularly in energy efficiency and energy-efficient technologies for factories and homes and renewable energy. We need to reestablish the Partnership for a New Generation of Vehicles, which is languishing. We need to do more in natural gas and distributed power generation systems. We need to reauthorize, Mr. Chairman, the Strategic Petroleum Reserve. I need the full authority to act on an energy emergency. We need the regional Northeast home heating reserve low-income energy assistance programs.

Let me conclude with something that you and this committee are working on, and, I must say, most effectively, and we hope that you conclude action on it, and that is the issue of the soundness of our electricity grid. I know that the committee is working in a bipartisan fashion, and we urge you to act. We are concerned about the reliability of the grid this summer and over the next several years. We need to do everything we can to keep the lights on and the air conditioners humming when temperatures soar, and during the last several summers utilities have been stretched to the limit. Spot prices for electricity rose dramatically. Factories were forced to shut down their operations and send workers home. Some areas experienced rolling blackouts. I am concerned about the tight electricity in the Pacific Northwest and California. We appointed a power outage study team to identify what went wrong. The Post team, the team we appointed, determined that we need a new framework to adjust for liability problems. Their report implies that things could get worse before they get better.

Mr. Chairman, we need a comprehensive restructuring bill. I know you are working on it, and I urge support for this initiative.

Chairman BLILEY. Thank you, Mr. Secretary.

We will now begin the questions. The Chair will enforce strictly the 5-minute rule so that everybody gets a chance to ask questions.

I will also point out that it has come to the Chair's attention that we will probably have a vote at 10. It is the Chair's intention to keep the hearing going, so those of you who are not asking questions, if you could go vote and come back quickly, we can keep this going.

The Chair recognizes himself for 5 minutes.

In your investigation, Chairman Pitofsky, it is my understanding that the taxes on a gallon of gasoline in Chicago—am I right that they are about 65 cents?

Mr. PITOFSKY. I think that is about right.

Chairman BLILEY. How does that compare on average for the rest of the country?

Mr. PITOFSKY. I can't answer that. I can get the answer for you. Taxes vary, of course, and I am not sure about the level of taxes in all parts of the country.

Chairman BLILEY. My Cajun tells me that it is 36 percent of the price.

Secretary Richardson, yesterday a major generating facility went down in the Northeast, and the day before a major facility in the Pacific Northwest and California went down. As a result, both regions remained very vulnerable to power outages. How close did they come?

Mr. RICHARDSON. In New England the unexpected loss of the Seabrook nuclear plant caused some concern. Fortunately, a cold front rolled through the area yesterday, and the situation is expected to be much better today.

On the west coast, the Pacific Northwest right now is experiencing an extreme heat wave, and we have the Bonneville Power Administration and our Federal teams in a preparatory status. There could be some rolling blackouts there, but because of the intensive efforts that we have made around the country in some of these reliability summits, I think we are ready.

California, they are having extremely hot weather. Emergency measures were taken yesterday, and the region just barely was able to avoid rolling blackouts.

Chairman BLILEY. What steps can we take to begin to reduce the vulnerability of the Nation's interstate transmission grid?

Mr. RICHARDSON. Mr. Chairman, I think you are doing this right now working on legislation. We have an adequate transmission generating capacity in the country. We have to do more in emergency energy efficiency. I think a bill that deals with reliability, with transmission, with more generating capacity, that has an investment portfolio that contains our commitments to renewable energy.

In other words, Mr. Chairman, pass our comprehensive electricity bill, fund energy efficiency programs, and help us with our energy grid research and development initiatives, but most importantly I think the fact that the Senate and the House are moving is promising, but I urge you to move as fast as you can.

Chairman BLILEY. Thank you.

Administrator Browner, we will be hearing testimony later today that puts much of the blame for volatile gas prices on a patchwork of constantly evolving government rules and regulations designed to protect the environment, including reformulated gas rules, refining requirements and so forth? Chairman Pitofsky specifically cites the introduction of Phase II regulations for reformulated gas as one specific factor that could have caused, and I say could have caused, recent price spikes in the Midwest. Has the Clinton Administration conducted a review of the environmental requirements that apply to the gasoline industry from soup to nuts, refining, distribution and consumption, to ensure that the industry is being regulated in a holistic way, or are we still doing it on an ad hoc basis?

Ms. BROWNER. The requirements that we have put in place in terms of refineries and how they do their business are in keeping with the 1990 Clean Air Act amendments. Since it was passed by Congress, there has only been required for sale two new types of gasoline, RFG I and RFG II. EPA did late last year adopt a new requirement for conventional gasoline and the reduction of sulfur because of the very real health problems associated with high sulfur content. We worked with the industry to craft a flexible pro-

gram. They get between 4 and 6 years to make those adjustments in sulfur content.

The truth of the matter is if you look at what EPA or Congress has required of the oil companies in terms of cleaner gasoline over the last two decades, the only requirement that is currently in place is the requirement for Phase II of the reformulated gasoline. And as I said earlier, that recipe was the product of a negotiated rulemaking with the industry on the order of 7 years ago. So we gave them a lot of flexibility and a lot of notice as to what the specific recipe would be.

Chairman BLILEY. The Chair now recognizes the gentleman from Tennessee Mr. Gordon.

Mr. GORDON. Thank you, Mr. Chairman.

First let me thank this distinguished panel of public servants for joining us this morning, and thank you for the many personal, financial, and family sacrifices that I know that you have given really to make our country or help make our country the envy of the world. In terms of quality of life and economic prosperity, you have all played a tremendous role in that. It would be sort of counterintuitive to what we do in Congress, but it would be interesting to have a hearing where you can come up and tell us about the successes and challenges that you have overcome. That is the reason that the rest of the world looks to us as really a leader.

Secretary Richardson, you have inherited as many big-time problems as any Cabinet Secretary could, and I want to thank you for reversing the government practice of opposing nuclear workers' health claims and also for many of those cleanups.

I know that you have taken a large role or really the lead role in trying to help OPEC increase its production. Could you tell us a little more about if you are expecting additional increases, what we can do, and what we can expect there? And also the administration is not a Lone Ranger in establishing energy policy. What can we in Congress do to give you more tools to help increase production as well as help us get more through conservation out of the energy sources that we have?

Mr. RICHARDSON. Congressman, since we started working with OPEC and engaging them forcefully, as I say, there have been 3.5 million barrels more per day in 2 decisions that they made, 1 in March and 1 about 10 days ago in June. We think that these are favorable developments, but they are still modest steps. I believe we need a strategy in this country that does not rely on imported oil, that develops alternative sources of energy, that deals more with energy efficiency and energy renewables and helps our domestic producers. I think that is the key.

We are particularly concerned, Congressman, about a refinery problem in Kuwait, an explosion that took place that should affect supplies principally to Asia, but eventually we are studying the ramifications for what it means for us.

OPEC is going to meet again in September, and our objective will be to urge them to keep an open mind about further production increases. Their last increase is close to 800,000 barrels per day, and if you add non-OPEC countries, Mexico, Oman, possibly Norway, that they will do more, we could be close to 900,000 barrels a day. That is important to the American consumer because we do need

more production, more supply. Demand is exceedingly high. Having more production, not just for the international economy, but for the world economy, for our economy, is important.

I would just close by saying we need to work together to pass the President's tax incentives on energy efficiency, on domestic oil and gas reduction, on alternative sources of energy, on renewable energy, on the comprehensive electricity bill which is part of the soundness of our grid. On an emergency basis we need to have an authority for the Strategic Petroleum Reserve. I am worried about a potential emergency. For the Northeast, we need the authority to establish a home heating reserve. But these are initiatives that we can work together on.

Mr. GORDON. Secretary Browner, based upon the 1990 Clean Air Act that you mentioned passed virtually unanimously as a bipartisan effort, could you give us a little history lesson on what was the reason for this Clean Air Act? What were we trying to accomplish, and why are we now 10 years later—where are we?

Ms. BROWNER. I think in 1990 there was a shared bipartisan agreement that we needed to do more for cleaner air in this country, and I think with good cause, and in a very, very thoughtful way the Congress crafted the Clean Air Act, which looked to all of those who contribute to air pollution in this country to really do their fair share, whether it be mobile sources or stationary sources.

I think Congress was particularly concerned about the levels of pollution in the most affected and polluted areas and put in great specificity for the requirements for cleaner gasoline, including a requirement that the cleaner gasoline would have an oxygenate, and in essence today there are two oxygenates.

Mr. GORDON. What is the real basis? What is the payoff?

Ms. BROWNER. With cleaner gasoline, we are seeing dramatic reductions. It is equivalent to taking 16 million cars off the road. That means better health protections for our children, fewer asthma attacks and respiratory illnesses. Now, the job is not done, and we need to continue to work together, but clearly the 1990 amendments, the clean air amendments, are contributing to cleaner air.

Chairman BLILEY. The Chair now recognizes Mr. Tauzin.

Mr. TAUZIN. I thank the Chair.

Mr. Pitofsky, you have a lot of work to do at your agency, and before you go off spending a lot of taxpayer money chasing down this investigation that everybody seems to want you to follow, I would urge you to look at two places quickly. The first is an article in the Chicago Sun Times dated June 26, 2000, by Ben Lieberman. I am going to quote from it quickly. He talks about how, first of all, Joe Lockhart has blamed this on oil company shenanigans. Gore said big oil is gouging American consumers, and Carol Browner indicated this is not about the reformulated gas program. But the title is White House and Federal bureaucrats are trying to find out who is behind the recent surge in gasoline prices, particularly in Chicago and Milwaukee. Somebody ought to just hand them a mirror. It points out that your investigation should not take long. The real lesson here is when Federal Government micromanages fuel supplies, costly unforeseen problems emerge. The solution is for legislators and regulators to consider such possibilities before

taking action, not to divert blame by concocting silly conspiracy theories after.

They list the reasons why they have these problems in Chicago and Milwaukee: First, the June 1 date for the Chicago area on the reformulated gas. The June 1 date, middle of the summer, high peak demand, we switch to a reformulated formula that applies only to this area, leaving stocks at a low level when consumers need supplies.

Second, greater-than-expected difficulties in producing and delivering the type—the special type of reformulated gas that is required in the Midwest because it is blended with ethanol that has to be shipped separately to mixing plants in the region.

Third, the pipeline problems that Secretary Slater talked about, and the fact that, completely ignored by the EPA, the cumulative effects of its many clean fuel requirements. One-third of the Nation using reformulated gas, but mostly the nonethanol type, and there are 10 different varieties required around the country, while two-thirds use conventional gasoline. So if you run short of the special varieties, you can't call upon conventional gasoline to fill the gap or another variety because it doesn't fit the special requirements of a given area.

Finally, other federally imposed fuel requirements add to the cost of specific States and regions.

I would cite one other place you can look and save us a lot of money before you do a lot of investigations. After all, you have already done extensive investigations looking at the BP-Amoco, Exxon-Mobil and Shell-Texaco mergers. I am sure that you have got a good record that you can look at and see what is happening regarding potential collusion.

Look at the Department of Energy publication, a beautiful explanation, a primer on gasoline prices. It tells us what went wrong in Chicago, and it predicts what was going to go wrong. It actually predicts. I want to read from your own publication. The State of California operates its own reformulated gasoline program with more stringent requirements even than the Federal Government. California prices are more variable than others because there are relatively few supply sources of its unique brands of gasoline outside the State. California refineries need to be run at fullest capacity in order to meet the State's demand. If more than one of its refineries experiences difficulty at the same time, California's gasoline supply becomes very tight, and prices soar. They mention the further away the necessary relief supplies are, the higher and the longer the price spike will be. Further in the publication, tighter environmental standards will be a factor in higher prices.

The lack of available refining capacity is already contributing to higher retail prices in California and is expected to spread to other States. Mr. Richardson, you predicted this. You talked about supply problems, chain of supply problems, the special Federal laws that require special gasoline in parts of the country, and you predicted the price spike in the region of the Midwest. You all knew it was coming. Vice President Al Gore in his book talks about the day when the awful gasoline combustion engine will be a thing of the past and has recommended higher taxes and higher prices on gasoline and on energy for years. The administration has said, save

the climate, we ought to use less gasoline. You predict that prices are going to go up, and then you try to scapegoat the investigation.

Mr. RICHARDSON. Could I respond?

Mr. TAUZIN. Please do.

Mr. RICHARDSON. First of all, we did not predict this. This publication is entirely consistent with our view and Secretary Browner's view that what needs to happen is despite the transportation problems, despite the refinery problems, despite the pipeline problems, the price differential for reformulated is 2, 3 cents, the price spike of 30 to 40 cents is still unexplained.

Mr. TAUZIN. How do prices get bid up? I want to know that. How do prices get bid up when shortages occur as they have occurred in Chicago?

Mr. RICHARDSON. The policy of this administration and the past administration has been that government does not get involved in pricing.

Mr. TAUZIN. But you help create shortages, and when you do, the independent service stations bid up the price because the branded cannot keep up with their own branded stations. Shortages are self-induced by the government which produces these prices.

Mr. RICHARDSON. The Department of Energy and the EPA have sent teams to the Chicago and Milwaukee area, and what we concluded is that the oil companies needed to give answers. There was too much of a price differential that could not explain this price disparity between the Midwest and the rest of the country.

Mr. PITOFKY. Mr. Chairman, may I say a word?

Mr. TAUZIN, we did not open this investigation because of what was said in op-ed pages. We opened this investigation because of a remarkable spike in prices. The west coast for years had the highest prices in this country. Now that questionable honor goes to motorists in Illinois, Wisconsin and Michigan. We want to find out why, and let me assure you here today that we will look at the factors that you have mentioned along with all other factors in this picture.

Chairman BLILEY. The Chair now recognizes the gentleman from Michigan, Mr. Stupak.

Mr. STUPAK. Thank you, Mr. Chairman. My district, most of us are 500 miles from Milwaukee, Chicago and even further to Detroit. Our gas prices are \$2.37, and they are not coming down. A part that continues to baffle me, and I have this chart from an earlier briefing, and I think it is an EPA chart, but the data is from the Oil Price Information Service, and it shows the retail price at \$2.12, but the wholesale price is down to about a buck 30. That is about an 80 cent spread. I don't have the updated charts.

Can anyone tell me why the wholesale price we have the spike, and then it goes down, but the retail price continues to go up? Why doesn't it go down when the wholesale price goes down? I am in northern Michigan. We don't have reformulated gas. We should have conventional gas. We don't have disruptions. Why are we in northern Michigan paying \$2.37? That is the high. That is for regular unleaded gas around the Petoskey area. Why don't our prices go down? Why don't they go down when the wholesale price goes down? Can anyone answer that one?



Mr. PITOFISKY. I cannot. It is a matter of some concern, and I have been rather bewildered why Michigan is now in the top three in terms of motor oil prices even though there are no reformulated gasoline requirements. There was a pipeline break that may have made a difference, but it didn't seem to make that much difference.

Mr. STUPAK. That is in the Lower Peninsula.

Mr. PITOFISKY. Rather than trying to speculate, I would rather get the evidence and report back.

Mr. STUPAK. Ours comes from Green Bay. It is a buck 86 down there. Why are we over \$2? Why don't they come down when wholesale drops? Why does retail stay up?

Ms. BROWNER. One of the things that has been completely puzzling to us is why you started to get a wholesale drop in Chicago-Milwaukee with no factual changes. Nothing changed until we asked for an FTC investigation, and then prices dropped precipitously on the order of 40 cents a gallon wholesale. That is why we welcome the FTC investigation. There is no credible answer put forward for Chicago-Milwaukee or your area.

Mr. STUPAK. Some members are saying and one of our Senators in Michigan is also saying we ought to get rid of the 18.4 cents Federal excise tax, and let's say you did that. How would that lower the price at the pump? Is there any guarantee the price at the pump would go down 18.4 cents?

Mr. SLATER. I can respond to that, Congressman Stupak. There is no indication that the price would go down even if you reduced the Federal gasoline tax. I can tell you that we would not be seeing the record level investment in the improvement of our transportation system, not only in Michigan, but across the country, by virtue of action of this Congress working with the administration to pass the largest surface transportation bill in the history of the country in 1998.

Just before you came in, I mentioned in my comments that we have followed the situation as relates to Wolverine pipeline, and even with the restriction that they have put on their service, they have resumed service to the prefailure rate in the eastern part of Michigan, and western Michigan was never affected. Your area was never affected. I would also like to make the point that Michigan and the automotive industry are working in partnership with this administration to deal with the alternative measures that we have to take to deal with our long-term fuel dependency needs, especially as relates to new generation vehicles, the 21st century truck, and again I wish to underscore the leadership that Michigan is providing in that regard.

Chairman BLILEY. The gentleman's time has expired. There will be another round.

Mr. STUPAK. Thank you.

Chairman BLILEY. The Chair now recognizes the gentleman from Florida, Mr. Bilirakis.

Mr. BILIRAKIS. Thank you.

Ms. Browner, as you know, EPA has been considering a request from the State of California for a waiver of the 2 percent oxygenate mandate for RFG. Your agency stated in writing that EPA has been working with California since the Governor's request in March 1999 to determine if a technical case can be made that the

2 percent oxygenate requirement is preventing or interfering with  $\text{NO}_x$  in California. EPA received this formal request from California last April, over 14 months ago. You certainly know, I think, that this matter has been of great interest to this committee. We brought it up many times, many letters have been written on numerous occasions concerning this waiver, and all those inquiries I would ask unanimous consent may be made part of this record.

What have we been told? I can cite the record here, but it would take up my time. On May 6, 1999, we were told by your Assistant Administrator that the Agency "did not want to waste a lot of time on this. I don't want the committee wasting their time either." Later that month we were told that EPA wanted to await the recommendations of the blue ribbon panel before taking any action, and once the blue ribbon recommendations were final, we were told in November 1999 that once EPA received additional information, your agency would work expeditiously to complete our technical analysis of this request.

I could go on and on here into February of this year and March of this year. It is now early summer. You have been consulting with California for 15 months on this matter. You have full knowledge of the California RFG program. You have had every last piece of information that you have requested for the last 139 days, and it seems like you have had more than enough time and that is tied in of course to what is happening here today, but by what specific date will EPA complete its California waiver request? I am sort of preempting Mr. Bilbray.

Ms. BROWNER. First of all—and you said this, and I think it is important to make certain that everyone understands—we did not have all of the technical information from California—and they have said this in writing—until February of this year. Yes, there were discussions that went on. There were meetings that went on, but a full application was not submitted to EPA until February of this year.

Second, I would like to point out this is the first time that this question has been posed to EPA, the question being does the 2 percent oxygenate which Congress wrote into the law in 1990, does that perhaps interfere with California's ability to meet air pollution standards? California has made a State decision, which we support, to ban MTBE. We think that MTBE as an oxygenate additive is not responsible anymore. It contributes to very real drinking water pollution problems.

Mr. Bilirakis, we are the first to tell you that this analysis is an analysis of first impression, and it is simply more difficult than we ever envisioned. We have, in the course of conducting the analysis, had to add additional analysis to what we thought was the original list of questions and issues, and I give you our commitment that as soon as we are done—and we are working, we have contractors working around the clock—we will make all of this public. We will make all of the analysis public. We will take comment on whether or not the ways in which the analyses were done are appropriate, and we will do all of that before we make any final decision vis-a-vis the California request. It is taking more time. It is a question of first impression.

Mr. BILBRAY. Would the gentleman yield?

In 1995, Mary Nichols was directly questioned by a Congressman from San Diego about this question. We have been in dialog since 1995. This is not something that your Agency has not been aware for a long time.

I yield back to the gentleman from Florida.

Mr. BILIRAKIS. You stated that your Agency would be able to complete the assessment by early summer of 2000.

Ms. BROWNER. It is far more complicated than we thought it would be. One of the questions that we had to look back at is not simply does ethanol and the 2 percent ethanol requirement perhaps interfere with what California is attempting to do, but does MTBE interfere. So there are more questions than we are having to answer to justify—

Mr. BILIRAKIS. You can't give us a specific date?

Ms. BROWNER. I would love to give you a specific date. Unfortunately, at this point in time I can't.

Chairman BLILEY. The gentleman's time has expired.

The Chair now recognizes the gentleman from Ohio Mr. Sawyer.

Mr. SAWYER. Thank you, Mr. Chairman.

I think if there is anything that we have heard this morning and we have seen mounting evidence for in recent days is that this is a problem that has a complexity of cause behind it, and at this juncture it may not be possible to add up the total contributing factors and come out with a balanced slate.

Let me ask you very quickly, Administrator Browner, you say in your testimony that the RFG program is not adequate to explain price differential. Does it contribute, and can you say at this point?

Ms. BROWNER. In developing the RFG recipe in 1993, we did look at what would it cost to make cleaner gasoline, and our cost estimates, which have not been disputed, were roughly 4 to 8 cents a gallon. And ethanol may bring an additional increment, but it is only an increment. So for the nonethanol RFG, it is on the order of 4 to 8 cents. And I think our point is proved out. When you look at the price of reformulated gasoline, the cleaner gasoline being sold across the country, if you take out Chicago and Milwaukee, what you see is a price virtually identical to the price of conventional, the noncleaner gasoline.

Mr. SAWYER. You have said that pipeline problems are not sufficient to explain the price differential that you have seen. Do they contribute, and if so, can you put a value on that?

Mr. SLATER. As far as we have tested it, there are no significant impacts by virtue of the restrictions underway. The restriction is 20 percent of operating pressure, but we have actually been able to make up, in one instance in particular, with the flow in the pipeline to actually rise back to the prefailure level, and that deals with specifically the area of Michigan.

Mr. SAWYER. Secretary Richardson, you have been working for months with regard to the particular diplomatic questions that surround large-scale base supply. Clearly over time that has been a contributing factor to the kinds of things that we have seen. Can you put a value on that, and can you put a timetable on the downward trend that we are likely to see?

Mr. RICHARDSON. Congressman, let me be one that, I guess, adds all of the contributing factors to the gasoline price rises that I

think are happening. There is no question that the international situation, the high price of crude, is a factor. There is no—there has also been, as we mentioned, refinery problems. There is unusually high demand at this very moment. Stocks are low, both gasoline, crude oil, nationally and internationally.

Mr. SAWYER. Is there a specific component of the cost that can be attributed to that?

Mr. RICHARDSON. I know that the Library of Congress came out with some percentages that we differ with, but we believe that all of these are contributing factors. There is also one that has not been discussed, and that is the utilization rates of refineries at 96 percent nationwide. But I think what is key in the Midwest is what Chairman Pitofsky has said. The differentials should not be so high at 40 cents.

Mr. SAWYER. It is no accident that I waited until last to go to Mr. Pitofsky.

If these don't add up, then it seems to me that the point that you made in your testimony, the fact that all companies raise prices at the same time, is not sufficient evidence of collusion. The courts have held that some plus factor must be present to demonstrate that behavior was reached; but for the quotation, collusion may be evidence that such an agreement exists.

Is this absence of any identifiable cause for a substantial portion of the price differential sufficient to meet that test?

Mr. RICHARDSON. That would be a plus factor. The courts have said if price movements are unexplained by economic circumstances, then that is a plus factor justifying an inference that the movements may have been as a result of collusion.

Mr. SAWYER. Thank you very much.

One final comment. Secretary Richardson, as you know, we have been working very hard together and within this committee to try to deal with the electric grid and reliability problems that you mentioned in your testimony. I have to ask you, if we were to pass the reliability legislation that stands before us freestanding, would that be sufficient to deal with problems this summer, or is that, coupled with transmission, a longer term problem?

Mr. RICHARDSON. We need a comprehensive bill. Don't give me just the reliability provision. I think we need transmission generation. We need the renewable portfolio. We need to give FERC the authority that it needs. We need the regional transmission organizations. Make it comprehensive.

Mr. SAWYER. Would it be fair to say that it is more important to do it right than to do it immediately?

Mr. RICHARDSON. Yes, but we have an imminent problem that we have to deal with.

Mr. SHIMKUS [presiding]. Thank you, my friend from Ohio, and you better hurry if you are going to get to the vote.

Administrator Browner, you mentioned there was a 4 to 5 cent price differential on average, and a small portion of that could—only a small portion could be attributed to ethanol. Can you expand on that and also tie that into the recently released report that we received from the CRS last week?

Ms. BROWNER. First of all, Congress gave flexibility to the refiners and the States on which oxygenates they would use. We fully

support the decisions made by Wisconsin and Illinois to go to ethanol. We think that it is good policy. When we look at the cost associated with cleaner gasoline using ethanol, we see at best a penny beyond the cost inherent in cleaner gasoline, which is something on the order of 4 or 5 cents higher than conventional gasoline. But when you look at the costs across the country, what you are seeing right now is that the cleaner gasoline, RFG gasoline, is selling for virtually the same price as conventional.

I might also point out that there are other cities that use ethanol, and we don't see the same kind of price differentials that we see in Illinois and Wisconsin. For example, Louisville is about 50 percent clean gasoline ethanol market, and yet their prices are very much in keeping with the rest of the country, I think, again, lending support that it is not the RFG program, and it is not the ethanol additive. It has to be something else which no one has explained.

Mr. SHIMKUS. Thank you.

This is a question for Secretary Slater, but first I want to recognize Secretary Richardson. You were a strong supporter of the biodiesel program, and we were able to pass the addition to the EPACT which allowed renewable credits for fleet vehicles.

Secretary Slater, we have a proposal, and this is in conjunction with Karen McCarthy, to use the same biodiesel equivalent to address the CMAQ portions, cleaner burning, and the Soybean Association just released a report, and this is how it ties to the EPA, biodiesel tied to 90-day subchronic inhalation study of exhaust emission required under section 211. When our side talks about a national energy policy, biodiesel is a perfect example of how you, through the supporting of CMAQ, can support a position taken by DOE, which I think now because of this study would be supported by EPA. And so I am asking you to look at the CMAQ legislation, and maybe that is something that we can move that would decrease reliance on foreign oil, improve air quality and would help the transportation system. Can you respond to that?

Mr. SLATER. Mr. Chairman, I think your point is well taken. What it does is it underscores the fact that when we passed the TEA-21 legislation in 1998, not only did we pass a bill to provide record level investment in highways and transit, but as Administrator Browner said, we also passed one of the most potentially significant bills. It is largely based on the flexibility and the creativity that we have within the CMAQ program.

Your suggestion that we work together in this regard is well placed. We are actually doing so, but we would like to work closer with you and your colleagues to move this effort forward.

Mr. SHIMKUS. Thank you. I think it addresses national energy security, clean air and all of the above.

Secretary Slater, can you address the pipeline issue and the debate currently whether ethanol transportation in the pipeline versus petroleum-based is—works against each other? I have heard comments that ethanol can flow in pipelines just like petroleum-based gasoline, and that should not be a hinderance to the cost debate?

Mr. SLATER. Clearly that is our belief. And the key from our vantage point is assessing the integrity of the pipeline and the safety

of it. We have, as I noted earlier, about 150,000 miles of pipelines across the country. Those pipelines transport about 60 percent, as noted, of the crude oil moving across the country, and so it is a very important transportation system, very critical to the economic strength of the Nation, and in this instance we have really worked closely with the Congress to deal with the capacity capability of two pipelines in particular, Wolverine and Explorer.

Mr. SHIMKUS. Thank you. I would like to give my colleague, Mr. Green from Texas, if he has a question directed to Administrator Browner, that is the one you should take because she is leaving.

Mr. GREEN. I thank you. I am glad we are having this hearing, and I welcome Secretary Richardson back to this committee, as a friend and former Member of Congress. And I followed you at the Department of Energy coming from Houston, some of the things that you have been trying to do, boosting domestic production and negotiating with oil-producing countries. We would like to see more domestic production.

First of all, I am just shocked seeing the last question about producing—transporting ethanol through pipelines. We have had testimony that that is not possible. It has to be trucked.

Ms. BROWNER. You can't.

Mr. GREEN. So it is not as efficient to move as an oil-based additive, RFG?

Ms. BROWNER. We agree that you cannot send it through a pipeline.

Mr. GREEN. So I can truck it over the road cheaper than I can use a pipeline?

Ms. BROWNER. In some instances that is the case.

Mr. GREEN. It disagrees with what your Department has said. I am concerned about the possible ban on MTBE because of the problems with ethanol, and I know that the Congressional Research Service said that ethanol wasn't a contributing factor. I think that was interesting because my colleague from Michigan stated that the wholesale price is lower, but the retail price is higher, and every one of you talked about how it is the Big 7 oil companies—that disparity is they sell it to a jobber or distributor, and they sell it to a retailer. I hope that the investigation looks at the whole gamut instead of saying we have the Big 7, and they are bad. The information that you all agreed to today would not show that there has been a price spike in wholesale. Hopefully the FTC and everyone will address that, too.

In March of this year, the DOE presented testimony to the committee that if MTBE were not used in gasoline, that refiners outside of California would have to spend a billion to \$2 billion in capital investments to continue producing an acceptable quality of gasoline. I know in this committee and in the halls of Congress, I have heard ethanol can replace MTBE, and just from the statement that, again, you can't transport ethanol most efficiently, because I hope that our EPA doesn't tell me that it is more efficient to truck across the country than it is using a pipeline. I hope that is not the case.

And to replace ethanol, we don't have any other substitute, and yet we can grow all of the corn we want to, and it is not available.

I hope that our agencies will be looking for something, if not MTBE, something like it, that it is not a problem.

My question is do we believe that a ban on the use of MTBE and gasoline would contribute to increases in the price of gas, since DOE has the price of gasoline, and then we will get to EPA?

Ms. BROWNER. If I might respond, the administration has been very vocal in asking Congress to work with us to craft legislation that would lift the 2 percent oxygenate requirement currently in the law, which means that MTBE would not be—

Mr. GREEN. That is not my question. I asked if we stopped MTBE today or 3 years from now, and all we have is ethanol, would that increase the price of gas at the pump?

Ms. BROWNER. Our position is that you should change the law. You can change the law and replace it with a renewable standard, which is a responsible thing to do.

Mr. GREEN. Is ethanol the renewable?

Ms. BROWNER. We are suggesting that it could be biomass, rice waste, yard waste. There is a tremendous opportunity in this country to go to a renewable standard.

Mr. GREEN. I support the effort for a renewable, but it cannot produce the volume that we need to have. Ethanol cannot produce. If we eliminate reformulated—and, again, I hope that is the case—if we eliminated MTBE, and we have had testimony here, if we did that, we would have a price spike in gas.

Ms. BROWNER. The solution is to change the law. That has been our position from the beginning.

Mr. GREEN. Sure, we can change the law, but that is not what is happening now. You are here to talk about the issue of why we have high gas prices in the Midwest. The Midwest utilizes mostly ethanol.

Ms. BROWNER. Because it is readily available, and it is cost-effective.

Chairman BLILEY. The gentleman's time has expired.

Mr. GREEN. Thank you.

Chairman BLILEY. The Chair recognizes Mr. Oxley.

Mr. OXLEY. Thank you, Mr. Chairman.

In my opening statement I talk about the fact that today we are importing 52 percent of our oil. During the Arab oil embargo, that was 43 percent. Last month the administration delivered testimony outlining the Clinton-Gore energy policy, and there was a reference to one project in the government Industry Oil Reservoir Class Program that added 2.4 million barrels of oil from one field. EIA recently estimated that ANWR contained 10 billion barrels of recoverable oil. Why does the Clinton and Gore administration's energy policy continue to ignore the possibilities of developing that resource in the ANWR region?

Mr. RICHARDSON. Congressman, we are opposed to the use of development of ANWR for oil and gas production because of environmental importance of the region. It is our view that in addition to that, 70 percent of the American people support protection of ANWR for future generations.

Mr. OXLEY. I wonder if that policy was taken before gas prices went sky high?

Mr. RICHARDSON. You are making a good point. We need to boost domestic production. We have a package on domestic oil and gas production that deals with marginal wells, G&G expensing, delayed rentals. Deep water royalty relief, I think we need to reauthorize that late this year. We are working in Federal lands in protecting environmentally sensitive areas.

Mr. OXLEY. How much oil could you—given your policy, how many barrels of oil would that produce?

Mr. RICHARDSON. I will get that for you.

[The following was received for the record:]

Estimates of added oil production due to various tax incentives are:

*Marginal well tax credits:*

- The Administration continues to examine marginal well tax credit proposals that are cost effective and targeted to prevent well shut-ins.
- Estimates of added oil production from such a credit have ranged from approximately 10,000 barrels of oil per day to 150,000 per day depending on the particulars of the tax credit and forecasts of future oil prices

*G&G expensing:*

- DOE estimates that allowing 100% expensing of all G&G costs in the year incurred would result in 25,000 barrels of oil equivalent per day.

*Delay rental payment expensing:*

- DOE has not estimated the added oil production from this tax provision.

*Deepwater royalty relief:*

- MMS forecasts that natural gas production from deepwaters in the gulf of Mexico will increase from the current 1 Tcf per year to 2.5 Tcf per year by 2010. This increase will be in response to deepwater royalty relief incentives as well as improvements in technology.

Mr. OXLEY. Ten billion?

Mr. RICHARDSON. This is a combination issue with the Department of Interior, as you know, because we are dealing with public lands. But the administration's view is that this would not be a wise move. There is enough domestic production in the rest of the country. We are proceeding—

Mr. OXLEY. Then why are we now relying on over half of our oil supplies from overseas?

Mr. RICHARDSON. That has been a historical trend throughout administrations. The good news is that we have reduced our reliance on OPEC, and we have gotten more from Canada, Mexico, Venezuela, our own hemisphere and other non-OPEC sources.

The cornerstone of our policy should be to boost domestic production, to not have so much reliance on imported oil, and what we need to do there is to deal with tax credits for energy efficiencies, domestic oil and gas production, energy renewables. We need to find ways to tap our own and help our own domestic resources.

Mr. OXLEY. If all of that happened, can you even get close to 10 billion barrels as projected by working ANWR?

Mr. RICHARDSON. I think there is disputes about the impact of ANWR. I have seen varying reports about how much you can get, Congressman. My point is that this administration, based on the biodiversity, on the environmental importance of the region, the fact that we are in the north slope of Alaska already drilling—

Mr. OXLEY. Thank God we were up there. If we were sitting here 25 years ago and debating this same issue, Prudhoe Bay and building the pipeline—the pipeline project, now 20 percent of our oil



comes from Alaska, that passed by 1 vote in the Senate. The Vice President broke the tie. What if we had not had the courage and the foresight to open up Alaska. And I would suggest to this administration this is the same old song where it is never the right place to discover oil in our own country, it is never the right time, there are always environmental concerns. We have shown that we can drill for oil in Alaska safely and do it environmentally and produce the kind of oil that the American public is expecting and taking for granted.

Now all of a sudden we can't drill in ANWR, which, by the way, was the original site favored by the environmentalists, and the potential for developing three times the amount of oil that has been produced at Prudhoe Bay, and I find that a shortsighted, knee-jerk reaction to radical environmentalists, and I think it is a big mistake, and we should not be wringing our hands about high gas prices when we don't have the courage to develop our own domestic supplies.

Chairman BLILEY. The gentleman's time has expired. The gentleman from Texas Mr. Barton.

Mr. BARTON. Thank you, Mr. Chairman. Welcome to the energy and commerce committee.

Secretary Richardson, how much energy domestically does the United States produce in terms of quads, do you know, quadrillion units of Btus?

Mr. RICHARDSON. Can I call my Energy Emergency Agency expert?

Mr. BARTON. Sure.

Mr. RICHARDSON. We will give you that in the course of the questioning.

Mr. BARTON. Let me try another angle. Obviously we don't produce as much as we consume.

Mr. RICHARDSON. Right.

Mr. BARTON. As Secretary of Energy, you have spent quite a bit of time in the last 6 months encouraging other nations to produce more oil so they can export it to the United States?

Mr. RICHARDSON. More so the first round of OPEC in March than the last time. Most of my work was done through the telephone and meetings here.

Mr. BARTON. The record shows that you have traveled extensively, and obviously if you have been on the telephone, you know more about that than I do. But shouldn't we also be trying to maximize to the extent possible what we produce domestically?

Mr. RICHARDSON. Congressman, here is where you and I can work together. Just recently the administration, the President, announced a new policy that deals with domestic oil and gas production. There are three steps that I think are very important that independent producers would like to see: marginal well tax credit that we can work on in its formulation, what is called G&G expensing, and delay rentals.

Mr. BARTON. I think I only have 5 minutes.

Mr. RICHARDSON. My point is that we have a deep water royalty relief tax provision that we need to renew. We are trying to, in Federal lands, improve the access.

Mr. BARTON. In spite of these herculean efforts on behalf of the Clinton Administration, is oil production going up or down in this country? It is going down. You know it is going down, and I know it is going down. What are we doing on nuclear power? Does the veto on the nuclear waste disposal bill, does that help or hurt nuclear power?

Mr. RICHARDSON. Congressman, we have—we came to you on the nuclear waste bill with a provision that advanced the process, that Department of Energy would take title, we would move forward with legislation based on scientific—

Mr. BARTON. You never put that proposal in writing. That was a red herring. I asked you point-blank to put it in writing and—

Mr. RICHARDSON. I testified to it in front of you.

Mr. BARTON. You testified in vague, fuzzy, feel-good terms about. Sure, you did that. I will admit that.

Here is my point, and we are going to have a second round, so I am not going to belabor this, but I haven't seen any major initiative by the Clinton Administration to actually increase domestic energy production of any kind in this country, whether it is nuclear, oil or gas, coal, even solar and renewable. Now, we are a growing economy. If we are going to continue to grow, at some point in time we need to think about how to increase production of energy in this country. Don't you agree with that?

Mr. RICHARDSON. Congressman, I disagree with your characterization. We have budgetwise submitted increases, and we have not gotten them. I get the point you are making. My view is that we need to work together to pass a balanced package that involves energy efficiency and domestic production. That is our message.

Mr. BARTON. Let me switch to the Administrator at the Environmental Protection Agency. The PM 2.5 standards that your Agency put out a little over a year ago when we had the hearing before this committee on a bipartisan basis, my recollection was that we strongly encouraged that those be delayed so we could do the science and make sure that the standard made sense. Is that your recollection?

Ms. BROWNER. You are referring to the PM 2.5, and we are engaged in what Congress directed us to do, to do a 5-year review.

Mr. BARTON. Didn't the court just strike the standard down?

Ms. BROWNER. The court has raised a question as to whether or not Congress, in granting to EPA the authority to set public health air pollution standards based upon the best available environmental standards—

Mr. BARTON. Didn't the court strike it down and say that you were legislating and not implementing, and that Congress should do that instead of EPA?

Ms. BROWNER. That is the question that is before the Supreme Court, whether this body should set air pollution standards, or whether the Environmental Protection Agency should set air pollution standards. That is the question before the Supreme Court.

Mr. BARTON. Should energy policy be set by the Department of Energy, or should it be set de facto by what the Environmental Protection Agency does?

Ms. BROWNER. Mr. Barton, my job is clean air, clean water for the people of this country.

Mr. BARTON. Would you agree that the Clinton Administration energy policy has been set de facto by what you have done at the EPA?

Ms. BROWNER. Absolutely not. I am acting within the guidelines of what Congress told me to do in 1990, which was to set a recipe for cleaner gasoline. We did that with the industry in a negotiated rulemaking in 1993. They have had 7 years' notice to bring cleaner gasoline. That cleaner gasoline means better health, fewer respiratory ailments and asthma attacks for tens of thousands of people in this country. It is environmental policy. It is public health policy. That is what we do at Environmental Protection Agency.

Chairman BLILEY. The gentleman from Chicago, Mr. Rush.

Mr. RUSH. Thank you, Mr. Chairman.

I have a couple of questions for Ms. Browner. Since the beginning of this gasoline crisis, ethanol has taken a lot of blame for the skyrocketing gasoline prices. Today's hearing, a little later the industry may argue that they are for ethanol, but when this first made national news and ethanol was blamed, no one from industry defended ethanol or the RFG program. I would take any industry praise of ethanol and the RFG program clearly with a grain of salt and some kind of misgivings. I think that they have been very disingenuous in their whole approach.

I, like many other observers of this crisis, believe that the oil companies are not in favor of the RFG program and ethanol, and I believe this crisis is a convenient way for the industry to scare the gas-buying public into some kind of disfavoring ethanol or discrediting ethanol. I would like for you to share your thoughts on my theory.

Ms. BROWNER. I do think that it is very, very noteworthy that the two areas where the cleaner gasoline price spikes occurred were in the areas where ethanol is used because of the State decision, and it is a decision that this administration supports, and we think that it is good for farmers in the region. There is nothing that we can find to justify the price spikes based on the local requirement to use ethanol. Ethanol is used in other areas of the country, not exclusively like it is in Chicago and Milwaukee, but, for example, in Louisville, when 50 percent of their cleaner gasoline is an ethanol-based cleaner gasoline, and yet we don't see these kinds of price spikes. If ethanol were the cause, we should see it in other parts of the country.

I certainly think that the questions that you pose are legitimate questions. Why were only two areas of the country subject to these kinds of price spikes? And I certainly think, based on what the Chairman of the FTC has said, those are the kinds of questions that they are going to be looking at.

We think that ethanol is an important part of a fuels program in this country, and we would like to see a law passed by this body replacing the oxygenate requirement with a renewable standard, which would give ethanol an opportunity to be a part of cleaner gasoline both today and in the future.

Mr. RUSH. Currently there is a proposal at OMB for a carbon monoxide credit rule, otherwise known as a VOC adjustment, that might give a slight break to RFG, and as I represent an area that

relies heavily on ethanol, I would encourage you to work with relevant stakeholders to finalize this rule quickly.

Can you tell me the status of this rule?

Ms. BROWNER. Smog is a result of two components in gasoline, VOCs—which are volatile organic compounds—and carbon monoxide. When you add ethanol to gasoline, you decrease the amount of carbon monoxide. So we are considering an adjustment to the Reid Vapor Pressure that could take into account the benefits of ethanol, the carbon monoxide reduction. You also get toxic reductions.

We are hoping to make that proposal public as soon as possible, perhaps as soon as late this week, early next week. We were delayed in making our proposal public specifically for the reasons that you note. We worked very closely with the State of Illinois, who brought forward some ideas that we thought were responsible and should be incorporated into our proposal. We are hopeful that will be put into the Federal Register in the next week at the latest, and then we would take comment. It is a proposal. We would review those comments and make a final decision in time for next year's clean gasoline program.

Mr. Chairman, this issue came up earlier. The cleaner gasoline program is a summertime cleaner gasoline program. That is why it takes effect when it does, June 1. That is when smog, air pollution levels go up. This is a summertime program that we are talking about. It is in effect for about 15 weeks out of the year during the time when you have the highest human health and public health concerns because of pollution levels.

Chairman BLILEY. The gentleman's time has expired.

The Chair now recognizes the gentleman from Michigan, Mr. Upton.

Mr. UPTON. Thank you, Mr. Chairman.

Mr. Slater, I just want to correct something in your testimony when you said that the pipeline supply did not affect western Michigan. My district cannot get any further west. I have Lake Michigan, and it did dramatically impact our district. We have talked to our suppliers again this morning.

Mr. Pitofsky, I want to say, I was on the—doing a radio talk show, I guess, about 2 weeks ago, and it talked—I had a call from a constituent who said while he was at church, he came out and the price at the gas station across the street went up 8, 10 cents a gallon, and he asked me what might have caused that. My suggestion was that perhaps the owner showed up that morning to raise the price.

I, too, have a lot of concerns about how the price in the wholesale cost can go down 40 cents, and yet the prices at the pump actually went up, didn't even stay stable. My gas prices were \$2.15 a week and a half ago. Monday when I left Michigan to come back, they are \$1.89. I am looking anxiously to seeing your report as it impacts the Midwest.

Mr. Richardson, I subscribe to the supply/demand theory, and I can remember well last winter when we had a spike in gas prices. At about that time, the OPEC nations were meeting. In fact, on the House floor we took up legislation that provided the President authority to turn off the spigot of foreign aid if they didn't open the

spigot with regard to increased production. In fact, they did increase production. At least they said they would. Have they complied fully with what they agreed to last winter?

Mr. RICHARDSON. Congressman, the answer is there has been an increase since you mentioned that floor debate of 3.5 million barrels per day increase. The increase right after your intervention by close to 2 million barrels per day, we believe they have done it. There is always what is called leakage.

Mr. UPTON. So they did 100 percent of what they said that they would do last winter?

Mr. RICHARDSON. I am never going to answer absolutes again in my life, but they have pretty much stuck to what they said that they would do both in their March increase, which is close to 2 million barrels per day if you add OPEC and non-OPEC, and the only changes have been in, for instance, Iraq. They may be doing less than anticipated. Non-OPEC, Mexico, Norway, have pretty much done what they said they have. So the answer is generally yes.

Mr. UPTON. Although most experts said that the increase they agreed to last week wouldn't impact the price very much at all, how quickly will they step up production to meet that goal?

Mr. RICHARDSON. Usually it takes 6 weeks for the oil to hit the tankers and get into this country. Our view is that it will have a modest positive effect when you have more production, and we are looking at 800,000, 900,000 when you add OPEC and non-OPEC. The problem has been unusually high demand and low stocks, low stocks of gasoline and crude, both nationally and internationally. That has been a fundamental problem, and then when you add the other concerns about transportation and the pipeline and refinery problems, it adds to the ability of crude oil and gasoline to come into our market.

Mr. UPTON. Where does the oil that we currently pump in Alaska go? Doesn't a lot of it go to Japan?

Mr. RICHARDSON. A lot does.

Mr. UPTON. Eighty percent?

Mr. RICHARDSON. I don't have the statistics, but it is high.

Mr. UPTON. Is there any effort to perhaps divert that back to the United States?

Mr. BILBRAY. No oil refineries.

Mr. RICHARDSON. Do you want me to yield, Congressman?

The problem is a number of California Members have approached us about moving that, but if I can yield.

Mr. BILBRAY. If the gentleman would yield, one of the problems is that the oil refineries on the west coast, there has not been a new oil refinery built there in 30, 40 years. The oil has to be refined somewhere.

Mr. PITOFKY. I can be of some help on this. There was a portion of Alaskan oil that was shipped out of the west coast to Asia, but as part of our negotiations with the parties in the BP-Arco matter, the parties have agreed that that kind of exporting would discontinue in the future.

Chairman BLILEY. The gentleman's time has expired.

The gentleman from Florida Mr. Stearns.

Mr. STEARNS. Thank you, Mr. Chairman. My questions are for Secretary Richardson.

Let me follow up with what Mr. Barton had mentioned. How much petroleum does this country produce? Do you know?

Mr. RICHARDSON. I think my expert—

Mr. STEARNS. Do you know personally? How about how much gas? How many tons—

Mr. RICHARDSON. Let me bring the Energy Information Agency.

Mr. STEARNS. I understand what you are saying. You don't know.

Staff has indicated to me that they asked at this hearing that you provide testimony. The other groups have. The Environmental Protection Agency provided testimony before the hearing. The Department of Transportation did, the Federal Trade Commission. Your office was the only one that did not provide testimony. In fact, I am told by staff your office refused, yet May 24 you provided testimony. Why aren't you providing testimony?

Mr. RICHARDSON. Congressman, I don't know the facts on that. I had prepared testimony that was—that I gave.

Mr. STEARNS. Senator Byrd complained about your responsiveness. You knew about this hearing. The other agencies provided, and you refused to do it. Not only did you not provide it, when they came and asked you for it, you would not provide it.

Mr. RICHARDSON. I don't think that is a fact, Congressman. This is my former committee. I rapidly—

Mr. STEARNS. I can't hear you.

Mr. RICHARDSON. I told the chairman I would be available to stay as long as he needed me. I confirmed coming to this committee immediately, and I will stay as long as I am needed. The testimony is essentially the same testimony that I provided yesterday. I have been testifying—

Mr. STEARNS. There has been a whole new scenario since you testified in May.

Let me ask you another question. This is your budget that you request from Congress, and I assume that you and your staff, realizing how important energy is, that is the mission of your Department—on page 135 do you think that you requested more for research and development in the area of coal and power systems in your budget? Do you think it was an increase request or a decrease?

Mr. RICHARDSON. It was a slight decrease.

Mr. STEARNS. Nine percent.

Mr. RICHARDSON. Let me explain why. Because we postponed two coal generation plants that had been ahead of schedule. That was the reason. And we expect to make that shortfall up next year.

Let me also answer your question about production. The United States produces 5.7 million barrels per day. But on coal, I will go through nuclear, we increased our contribution to nuclear, the Nuclear Regulatory Research Institute; oil and natural gas, we have increased, Congressman—

Mr. STEARNS. Reclaiming my time.

Mr. RICHARDSON. —fossil fuels.

Mr. STEARNS. In petroleum and oil technology research and development, do you think that your budget you requested went up or down?

Mr. RICHARDSON. It went up.

Mr. STEARNS. It went down 8.2 percent.

What about plant and capital equipment? It went down by 23 percent. So your Agency, whose mission is to try and come up with alternative energy resources through research and development, right here in this report is not even requesting enough money to do the job, and you are coming here to say that you are doing the job?

Mr. RICHARDSON. You need to add our request for solar, renewable energy, wind, geothermal. You need to ask for our energy efficiency budget. The Congress has only funded 12 percent of the President's energy efficiency budget in the last 7 years.

I don't want to get—

Mr. STEARNS. Your overall request is down 7 percent in this graph.

You mentioned OPEC, and you said that this country is going to Venezuela to try and get extra sources. Isn't Venezuela part of OPEC?

Mr. RICHARDSON. Let me give you the members of OPEC.

Mr. STEARNS. Is Venezuela part of OPEC?

Mr. RICHARDSON. Yes.

Mr. STEARNS. The fact that you cited Venezuela separately as a country you are—

Mr. RICHARDSON. My point is that we are getting our sources a lot from our hemisphere, Canada, Mexico, Venezuela. My point is Mexico is not a member of OPEC. Neither is Canada. Our reliance on OPEC, Congressman, in the last few years, as a source of supply for the United States has declined.

Mr. STEARNS. My point is, Mr. Richardson, if I came up here, I would know these facts. I would make sure that your budget included increased funding if you want to take the high ground to say that the Department is actually trying to solve this problem. And in the larger sense, OPEC, as we all understand, is a cartel. It is a monopoly. And this might be a question for the Secretary of the Federal Trade Commission. Here the Justice Department and the administration is trying to break up all of these companies like Microsoft and has this aggressive plan to do so. Why isn't the administration going after OPEC and using the leverage and the power it has through the executive branch to try and do something about this cartel?

Mr. PITOFISKY. I can't speak to diplomatic efforts in this area. As far as the law is concerned, challenging an agreement among sovereign states raises all sorts of difficult questions, the so-called act of State doctrine, and the Sovereign Immunity Act.

Mr. STEARNS. You could use your influence. You could use resources. You could use lots of things; trade, which I don't think that the administration is using fully.

Chairman BLILEY. The gentleman's time has expired.

The Chair announces that we will now take a 5-minute recess.  
[Brief recess.]

Mr. TAUZIN [presiding]. The Chair recognizes Mr. Bilbray for a round of questions.

Mr. BILBRAY. I would like to thank the Administrator for staying.

Administrator, I just want to make sure that in California all these years we have been trying to address the issue of not only cleaner burning gasoline, but also more cost-effective. We had

prices spiking for a long time. Now the 32 million people of California see this huge reaction in the Midwest, and we say, hey, doesn't anybody remember we are out here in California, too? It is almost like a perception that the Midwest really matters, but California is just taken for granted.

That aside, I would just like you to articulate that after telling the Governor, the Chairman, and this Member of Congress, and telling the California delegation Democrats and Republicans unofficially that it was going to be early summer, now it has been 139 days, 24 hours in those days, waiting patiently and being told, wait, one more study, one more report. We have been doing this for years. What is your explanation of why we do not have an answer in California?

Ms. BROWNER. The question that California has posed is a question of first impression. No one else has ever brought that question to EPA. No one has ever done the analysis. It has simply never, ever been done.

I am sure everyone can appreciate that it is a more complicated analysis than we originally thought. We are looking at all of the oxygenates and whether the 2 percent requirement may in any way hinder California's efforts, and California is leading the way on cleaner gasoline, and you, as a member of the Air Resources Board, were a part of this.

No one has forgotten California, but we want to make sure that we do the technical work. This body calls me up here all of the time and says, do the technical work. It simply is taking longer. I apologize for it taking longer, but I know you and everyone up here wants it to be done accurately.

Mr. BILBRAY. I have never heard anyone who has looked at what California is proposing who had real scientific basis saying that California was trying to retreat from an air quality issue.

Ms. BROWNER. We are not suggesting that at all.

Mr. BILBRAY. I have been informed that the Governor of Illinois wants to backslide and come off of number 2. California is asking for the flexibility to go to number 3.

Ms. BROWNER. We agree.

Mr. BILBRAY. We heard your testimony today. Somebody watching these hearings will hear what you just said, but remember what you said two questions ago to the gentleman from Chicago, saying that we want a renewable mandate, and we want it guaranteed up front. The trouble—is the crime that California is committing is we are trying to get a clean gasoline, but we are not willing to commit to a renewable standard?

Ms. BROWNER. You know that I am incredibly supportive of the California clean fuels program. We at EPA have in many instances worked to adopt components of that program because we see the benefits of it. There are two issues in front of all of us, but quite simply, the issue of MTBE is one where we have agreement. We all believe that the oxygenate additive MTBE presents far too many water pollution problems and, therefore, should be removed. We share your Governor's commitment to that. We have asked this body to pass legislation to do that. We are suggesting that in passing that legislation, it is an opportunity to create a renewable standard. And your own State has been supportive of a renewable



standard. Your rice farmers are supportive. They see an opportunity for biomass to—

Mr. BILBRAY. Reclaiming my time. The State of California has said that we would love to work toward it. But the renewable formula, the problem is not MTBE, the problem is a mandate of content that was well-intentioned in 1990 that has been proven to be deficient in the year 2000. The content mandate and what we are asking you—and I want to say this again, when I hear you say renewable, I support renewable, but I don't support a Federal mandate that gives one product or one industry a monopoly. We have already got enough problems with the gas industry having too much of a monopoly. I don't want to transfer from one industry to another.

Ms. BROWNER. We are the ones asking for investigations and saying that renewable should include your rice farmers.

Mr. BILBRAY. What I want to know is that the consumer—you have a clean air strategy that we are trying to do. We are trying to say that we have a cleaner, less expensive gasoline. Why won't the Federal Government allow us to do it? And you are saying that you can't prove yet that it is cleaner?

Ms. BROWNER. Mr. Bilbray, I have not said yes or no, and you are well aware of that. This body has told me I have to do a level of scientific analysis and present it to the public. California gave me their evidence in February. Taking additional time to ensure that the scientific analysis that this body always demands of EPA, and they have every right to demand, is properly done is my job.

Mr. BILBRAY. I will go back and say with the science we have in California, you have 139 days since you got the last piece of paper. You know, Mary Nichols and your staff members have known since 1995, that California came up with a better environmental option than a mandated content, and all we are asking is that you give us the flexibility to do better. We are not asking to backslide or back off like the Midwest. You have got professors in California, you have got editorials in the San Francisco papers that strongly support this administration, but they are asking questions. Why is it such a big deal now that it is in the Midwest with a price spike, and it has been—it hasn't been a big deal when we were in California?

Let me tell you flat out, I would love to see that we don't wait until August in L.A. when there can be a grand announcement made one way or the other or the fact that California is being taken for granted while the Midwest is now a political hotbed. This is not just this Congressman saying that. I hope that we are not playing politics. We have asked patiently. We have been patient through two administrations saying we have a better mousetrap. We know it. Why can't you give us an approval to do better, unless what it is is having basically a mandated content for certain products is essential to this administration's policy, and I don't think that the public health should be sacrificed for that.

You want to talk about ethanol, and you know that we were taken to court and we won the case before the court that a mandated content that hurt the environment was not going to be mandated.

Mr. TAUZIN. The gentleman's time has expired. The gentlewoman may respond.

Ms. BROWNER. No administration has done more for cleaner air, and, Mr. Bilbray, we have enjoyed a positive working relationship for the benefit of your constituents and all of the people of California. You know that we are trying to get a scientific, a technically accurate answer. This isn't about politics. This is about a complex analytical process. This is about science, and as soon as we have that done, we will make it fully publicly available, and everyone can comment on it.

Mr. BILBRAY. We waited for the National Academy of Science and study, study, study. The consumer and the environment back in California is saying, when will we get the answer, and the answer is not coming when it was promised.

Thank you for coming today.

Mr. TAUZIN. The gentleman's time has expired.

The gentleman from Ohio Mr. Brown.

Mr. BROWN. On April 10, 1962, six U.S. Major steel producers announced a sudden increase in steel prices. President Kennedy, reacting furiously, said a few days later, on price and wage decisions in this country with very limited restriction in the case of monopolies and national emergencies, strikes are and ought to be freely and privately allowed. The American people have a right to expect, however, in return a higher sense of business responsibility for the welfare of their country than has been shown in the last 2 days by the steelmakers.

President Kennedy continued, some time ago I asked each American to consider what he would do for his country, and I asked the steel companies the same. In the last 24 hours we had their answer.

Four days later, in response to President Kennedy's ringing denunciation, the steelmakers canceled their price increases.

I would like to ask each of you, I ask distinguished members of this administration, and I would like to ask the President to do the same, use the bully pulpit to demand accountability from oil companies for whatever you want to call it, price gouging, perhaps collusion, as Mr. Pitofsky might prove. I would ask also for the Republican leadership that they quit calling names and use the same bully pulpit to make that case that the oil companies have used every excuse, blaming clean air laws, pipeline breaks and everything they can, to raise prices even more than any of those single elements should suggest.

Unfortunately, the Republican answers have been, eliminate the DOE, refuse to invest in energy efficiency, refuse to invest in developing new sources of energy-renewables resources and fail to reauthorize the Strategic Petroleum Reserve.

I would ask Secretary Richardson, what do these failures on the part of this Congress, the proposal to abolish the Department of Energy, the refusal to invest in energy efficiency and reauthorize Strategic Petroleum Reserve, what has this meant to oil prices?

Mr. RICHARDSON. It has prevented us from having a balanced energy policy. I think what this administration has done is unprecedented economic growth, but at the same time we have lowered sulfur emissions. I think this is one of the main points of Adminis-

trator Browner. We need a balanced approach, one that helps our own domestic oil and gas producers, and we have before the Congress legislation to help them, tax incentives for energy efficiency, for fuel, for vehicles, for homes, for places of work, tax incentives for renewable energy.

We have increased investment, and we need to increase investment in domestic sources of energy-efficient technology for factories and homes, weatherization of low-income houses. The PNVG program was cut in Congress, which basically allows us to have more fuel-efficient cars, and do so in a time certain, and funding for that is going down.

Our efforts on natural gas, distributed power generations, we have, I think you mentioned, the Strategic Petroleum Reserve. As the Energy Secretary I have authority to do this in national supply emergencies. We need the full authority. I know that the House has moved, but the Senate has not yet.

We need also authority for a regional home heating oil reserve. We have not gotten it.

My point here is not to point fingers. We need to work together and deal with these issues in a bipartisan fashion, I think, if anything because of these high gasoline prices. If we approach both the demand and the supply side and the investment side, we can deal with this problem more effectively, and we can keep the fundamental goal of economic growth with protecting the environment. I think we have done that.

Ms. BROWNER. Mr. Chairman, I just wanted to thank the committee for honoring the long-standing prior commitment that I had. I was able to stay through the first round of questioning. If I might ask leave of the committee to have Gary Guzy, our general counsel, could answer questions in my absence.

Chairman BLILEY. Sure. We may submit some written questions to you until later.

The gentleman's time has expired.

I recognize Mr. Tauzin.

Mr. TAUZIN. Let me follow up on something, Mr. Richardson. I wanted to get my 2 cents in and didn't properly welcome you as a former colleague and friend. Let me first commend your Department, and I want those folks who may be tuning into this hearing to know that you published this primer on gasoline prices that is available at [www.eia.doe.gov](http://www.eia.doe.gov) on Web, and I assume that they can also contact your Agency and get this pamphlet. It is a great explanation of how retail gasoline prices occur in the marketplace. It is also, and I want to point out again to you, a real statement that anticipated the price spikes in the Midwest. It says that lack of available refining capacity, which is continually going down in America and affected by these reformulated requirements, the lack of refining capacity is already contributing to higher retail prices in California, that Mr. Bilbray pointed out, and is expected to spread to other States.

You predicted that it was going to happen. You should not be surprised by it. I want to offer this for the record, among the documents that we file, and I ask unanimous consent that it be part of the record.

Chairman BLILEY. Without objection, so ordered.

Mr. TAUZIN. Also dated July 3, an article in Business Week, entitled "Who Is to Blame," this has been about pointing fingers. The people in the administration are trying to blame the oil companies in calling for the investigation, and there is concern about EPA's decisions. But the article does a good job, and I want to quote one phrase: "the trouble in the Midwest should have come as no surprise to gasoline consumers in California. After the State mandated its own special reformulated gasoline that they blend in March 1996, the price of gasoline took off, jumping 30 percent to \$1.60 a gallon. Consumers were outraged. There were at least four separate Federal and State investigations of the California gas prices. No charges of improprieties were ever filed. Capacity in the State is so tight, whenever there is a refinery outage, gasoline marketers must fine out-of-State refiners who can meet the California requirements."

It is as simple as that. I suspect that you are going to go forward with your investigation because that is what you guys want to do, but I would ask you to consider the fact that every time this happens and all of the investigations go forward, we get the same answers. That it is marketplace disruptions in some cases caused because of new requirements in the content of gasoline for which the marketplace has a hard time adjusting.

I want to quickly take you through what I have learned about the situation in the Midwest, Mr. Richardson, and ask you, Mr. Pitofsky and Mr. Slater, and Mr. Guzy of the EPA, to think about what is happening in that marketplace before you go around charging people with corruption and chicanery. When ethanol has to be added to gasoline, it has to be shipped in separately and mixed near the marketplace, and the refining capacity drops, and shortages occur.

When refiners that have their own branded gasoline stations out there no longer have enough gas for this new reformulated mix to sell to the independent marketers, the independent marketers begin bidding up the price to get some of that supply. In a shortage the independents start bidding the price up, and the branded products have to keep up with that price spiral because otherwise their stations would go dry. The article talks about that 5 or 6 cents reformulated cost amounting to a 16-cent increase in gasoline prices when you create shortages.

What I am trying to say, and I hope that you look at this, there is a reason why we have had low gasoline prices across the country and a spike only in certain regions of the country, and it isn't because we only have gasoline shortages, we have a lot of oil flowing into this country. It is regionalized. And it is regionalized because of the fact that we decided, rightly or wrongly, on a drop-dead date of June in the middle of the demand season to impose new regulations for which there are short supplies. If we are going to cure it, we quit all of these charges and countercharges and simply understand how these markets work and maybe implement these changes on a gradual transitional phase instead of a drop-dead June 1 in the middle of the summer when everybody is using automobiles to get around the country.

Chairman BLILEY. The gentleman's time has expired.

The Chair recognizes the gentleman from Minnesota, Mr. Luther.

Mr. LUTHER. Thank you, Mr. Chairman. I wrote you, and I appreciate you having the hearing.

A lot of references have been made to Chicago and Milwaukee. I represent the metro area of Minneapolis-St. Paul. I assume your comments are the same with Minnesota in general, and there is nothing specifically about that area that would differ in your comments. I am assuming that unless somebody says something differently, because obviously we are greatly concerned, as well as Milwaukee and Chicago.

I appreciate the final words that Mr. Tauzin said because I think it is too bad—Mr. Chairman, I wish you had made those comments about no finger-pointing earlier in the hearing. I missed some of it because of the floor action, but I don't think anything would be more inappropriate here than to try to cast blame on a particular administrator or a particular Department over this particular issue.

When President Clinton took office, he clearly recognized the importance and the need for a strong, long-term energy policy for this country, and I think that through his actions he has been working in that direction, and I don't think that it is appropriate to be casting any blame. And what I hear being said as I follow this issue is that nobody can put their finger on it and say this is an explanation for what is going on, and that is exactly why the FTC is going to do what it is going to do, and that is highly appropriate.

Obviously, a couple of days after the FTC made that announcement, there were further changes in the whole pricing of this product. That needs to be looked at and scrutinized. We need to get to the bottom of it because this finger-pointing—you wonder why the American public is fed up with politicians. I come from Minnesota, the home of Jesse Ventura. This finger-pointing is the classic reason that Americans are fed up with the political parties and the political process.

What we need to do is get to the bottom, get to the bottom of the facts, and that is what I hear you saying you are going to do, and that is what we ought to do.

Would it be helpful if we brought people other than the Secretaries here; would it be helpful if we brought people from the industry in? How can this committee be helpful in getting to the bottom of what is going on, and how can we take action? I would like to know—if there is nothing that we can do during this period of time, please indicate. If there is something that we can do other than bringing heads of departments in and other people that could bring some answers, I would like to know.

Mr. PITOFISKY. On the narrow question of price behavior in the Midwest, I think we have all of the authority that we need. Yes, we will conduct this investigation. Maybe your interpretation of what will happen here is right. Maybe the evidence will show that no cases should be brought. As far as I am concerned, that does not mean that we should not investigate. I believe the people who are paying these high prices and being hurt by these high prices are entitled to an explanation, and that is what we will do.

As to the committee's role, I don't think that we need any assistance on this, but on the broader questions of OPEC, international oil industry and so forth, I leave it to others to respond.

Mr. SLATER. Congressman, I have shared our analysis of the pipeline situation, so I would let my earlier comments speak to the question.

When it comes to the broader balance comprehensive energy policy, there are a number of things that we currently have before the Congress that would clearly be helpful to us: providing the resources for the advanced vehicle program, supporting our efforts to continue to work with the automobile industry to move forward on our PNGV initiative, new generation vehicle.

Also, we have a major initiative with the trucking community in that regard as well. We announced that during Earth Month in Detroit with Mack Truck, Oshkosh and Caterpillar. We would like to be able to move forward aggressively on those measures.

We would like for the Congress to reconsider the prohibition to the administration as relates to our moving forward on reviewing and analyzing CAFE standards. We have seen a 50 percent increase in fuel efficiency since that measure was passed in 1975 and believe that we can make significant progress as we continue to work in partnership with all interested parties in this regard.

Clearly, our ability to continue to provide record-level funding for transit initiatives and intercity rail we believe also provides significant benefits.

I made a comment earlier about the fact that last year we enjoyed, for the first time in 40 years, significant ridership in transit, about 9 billion passengers. That accounts for or represents literally billions of gallons of oil saved.

Also, Amtrak has enjoyed, over the last 3 years, increases in ridership and improved service, and so I do believe that those measures provide great opportunities for us to balance our transportation system and to also bring fuel efficiency to a greater realization across the transportation enterprise.

Mr. RICHARDSON. Congressman, I would simply add, this is the Energy—used to be the Energy and Commerce Committee. You have primary jurisdiction over energy. I would suggest this is an issue that should involve environmental groups, the oil companies. It should involve citizens groups, labor unions, business people.

I think we can find solutions. We need to find a national solution, and what I am concerned about is that we are looking at strictly regional problems. I think we have to have a national policy, and the Secretary mentioned a number of initiatives that we need passed.

But, at the same time, there is also an international dimension which I have been dealing with which, you know, you might call some experts in that area to deal with the international ramifications. We are concerned both on the national side but also on the international side, factors that we can't control like the explosion in Kuwait of this refinery, like other disruptions that occur that involve infrastructure, and I think Secretary Slater can also contribute to this.

So I would urge you to have a national dialog on energy, with the objective being a bipartisan energy policy that might help us get through this not just the summer but long range more effectively than we have.

Mr. COX [presiding]. The gentleman's time is expired.

Mr. GUZY. If I may respond very briefly. One of the things that has characterized the cleaner fuels, cleaner gasoline program has been the significant lead time that the industry in fact has had to be able to meet the requirements with the initial phase in 1995 and phasing in in the Year 2000, and we would just ask that the administration has submitted principles to address the challenge posed by MTBE. We think they represent a serious effort to grapple with those issues, and we would ask this committee to consider those and move that forward. In addition, we would ask Congress to fully fund the administration's request for energy efficiency.

Mr. COX. The gentleman's time is expired.

The Chair recognizes himself for 5 minutes and welcomes his former antitrust professor to the panel. Unlike the President and the First Lady, I didn't study under Professor Bork. I studied under Professor Pitofsky, but hopefully I learned something in the process.

Mr. PITOFSKY. I look forward to your questions.

Mr. COX. Fortunately, a sufficient number of years has passed, I am not motivated to take advantage of the opportunity where I might have been as a student.

We are right now in the country, as we are all commiserating, more dependent on foreign oil than ever. Our own domestic production has gone down, down, down, down over the last 15 years, and we are not stimulating domestic production. To the contrary, it is being depressed. We are also not doing much to rely on nuclear power, not to my knowledge. I would ask the Secretary, does the administration formally support the construction of any ongoing nuclear power plant projects? Is there any construction project under way in the—

Mr. RICHARDSON. Mr. Chairman, let me just say the administration supports nuclear power as one of our options, and we have committed to that through increased research funds, as I mentioned earlier, and the issue of certification of new nuclear power plants through the Nuclear Regulatory Commission, but there have been no pending issues right now.

Mr. COX. Have any new nuclear power plants come on line during the Clinton Administration?

Mr. RICHARDSON. In the entire 7 years, no. Since 1975, none have come on line.

Mr. COX. Are there any currently under construction that the administration has supported?

Mr. RICHARDSON. Well, it is not a question of whether we support them or not, Congressman. It is an issue of licensing. And, as I have said, we believe that nuclear power is part of the energy mix, and we are supportive of efforts to increase research in nuclear power.

One of the problems—

Mr. COX. Are you supportive, for example, of the immediate construction of the light water nuclear power plant somewhere in America?

Mr. RICHARDSON. Well, if it is fully licensed, yes.

Mr. COX. And then where would this be going on?

Mr. RICHARDSON. Well, I think the Nuclear Regulatory Commission has a number of pending nuclear licensing issues. I will say

to you, one of my more immediate concerns is, the Seabrook nuclear power plant yesterday in new England has had some problems, and we are trying to work on that.

Mr. COX. The reason I ask the question is I do know the administration is supporting at taxpayer expense the construction of two light water nuclear reactors in North Korea. We agreed to pay for Kim Jong-Il and his regime to have two light water nuclear reactors, something to my knowledge this administration would never support in America; and I am just wondering why in North Korea we are supporting the construction of nuclear power plants instead of some safer means that doesn't pose a proliferation threat. Because, as we have heard in testimony, when those two nuclear reactors come on line in North Korea they will produce enough plutonium to make 60 bombs a year.

Mr. RICHARDSON. The reason for that is what is called the Agreed Framework that we signed with North Korea some 4 years ago.

Mr. COX. Well, I am very familiar with the Agreed Framework. I am just trying to contrast the administration's willingness to pay for it at U.S. Taxpayer expense, the construction of nuclear power plants in North Korea, and the lack of any nuclear power progress in the United States for the whole 7 years of the Clinton-Gore administration.

Mr. RICHARDSON. Congressman, the issue is not that we are stopping it. The issue is licensing. There are strict standards that have to be followed. We believe that nuclear power has to be part of the mix. We have increased research for nuclear power. We tried to resolve the nuclear waste issue.

One of the problems in nuclear power is the very high cost of building new nuclear power plants. The technology has not been advancing as rapidly as it should.

But, again, on the North Korea issue, what we got in return, Congressman, was a moratorium on reprocessing of North Korean nuclear weapons.

Now, there has been a breakthrough in North Korea. As you know, there is an easing of tensions, but the issue of the reactors is something that is pending right now.

Mr. COX. I just would have hoped that the U.S. input there would have been toward hydroelectric power or even coal, if we can't do it as cleanly as hydro, or some other means of providing electricity to people in North Korea who are admittedly very, very poor and not pose that proliferation threat.

On petroleum, Alaska is twice the size of Texas. Can we do more exploration in Alaska?

Mr. RICHARDSON. Yes, Congressman, and this administration has supported exploration in the North Slope, a petroleum reserve in Alaska. We also believe that initiatives that we submitted on marginal well tax producers, GNG expensing delayed rentals, if approved by the Congress, would help in the exploration there. Some of the more salient issues relating to exploration in Alaska is the ANWR issue; and we have said that we believe that for environmental reasons, for biodiversity, ecological reasons it is not in the national interests to explore in the ANWR.



Now, we do support further exploration. We have a proposal to deal with the deep water relief initiative. We have some areas in coastal areas where there is exploration. Off the coast of Florida, off the coast of California, we think it is too environmentally sensitive.

Mr. COX. I agree with that. But certainly not with putting all of that vast acreage of Alaska off limits. I would yield the Chair at this point—to the chairman for his return.

Mr. TAUZIN [presiding]. The chairman recognizes the gentleman from Chicago, Mr. Rush.

Mr. RUSH. Thank you, Mr. Chairman.

Mr. Secretary, Secretary Richardson, of course, we are concerned about the escalating and skyrocketing costs of gasoline at the pump. Of course, in my District, we are experiencing crises. People who have marginal lifestyles and people who are living on fixed incomes are experiencing all kinds of havoc because of the rising or the cost of gasoline.

However, I want to project forward a couple of months, and in March 1999, March 23, 1999, there was an announcement by OPEC that its member states were banding together to reduce the world supply of petroleum, and then again in October 1999, an announcement by the Energy Information Administration that prices for home heating oil will increase by 44 percent.

You know, that alarms me. Because I want to know, you know, for those same individuals who are experiencing this crisis in their lives because of the rising costs of gasoline, are we to expect similar crises as far as heating oil in the winter months, especially if we experience a severe cold winter season? And, also, is there any specific legislation that Congress has presented to the President to help stem the sharp increase in oil prices, given the fact that we are now reacting to the crisis that we are presently involved in and having projected a future crisis that is right around the corner?

Mr. RICHARDSON. Congressman, for your constituents—and I have been in your district, and I know how painful it has been both in summer and in winter, the summer with air conditioning; and I recall being in Chicago at a time when some of your constituents were suffering because of the extreme heat wave and lack of air conditioning.

What we think is necessary, Congressman, is several steps: Low income energy assistance—the President has resubmitted additional funds to provide low income energy assistance on an emergency basis. We need those funds from the Congress.

In addition to that, for constituents in Chicago and other parts of the country, our weatherization programs need to be expanded and reauthorized, and we have proposed that.

On home heating oil, we are concerned, Congressman. This is why we have proposed a home heating oil reserve of 2 million barrels based on a national supply emergency in case of a potential emergency, not based on market or price issues but based on an actual supply emergency. That has been languishing. I understand something passed the House yesterday, but it is not moving in the Senate.

I need full authority also for strategic petroleum reserve which can be used for national supply emergencies. I need the full authority to use that. We don't have that at this time.

In addition, we are going to continue our energy diplomacy which basically recognizes that what the international community needs, and we are all tied in here, is price stability, not so much volatility. That is what has been happening, and we are talking about developing countries and producer and consuming countries. And the price of oil is over 30, it is too high. At 10, it was too low. So what you want is something in between but dictated by the market.

We are also moving aggressively I think, as many have mentioned, with EPA and the Department of Transportation to deal with the pipeline and refinery problems that unexpectedly happened.

In addition, too, Congressman, we are talking to the American people about just taking some simple steps that involve energy efficiency. For example, finding ways to deal with the inadequate generation and capacity that exists, for instance, washing dishes and doing laundry in early morning or late evening when it is cooler or closing your blinds or drapes or shades to prevent sunlight from entering your room or something. Just a simple turning lights off in rooms you are not using and changing filters in air conditioners.

Now this is not supreme sacrifices, but if we did that we could save money, consumers would save money and electricity.

Mr. TAUZIN. Gentleman's time has expired.

Mr. Slater, you wanted to respond also?

Mr. SLATER. Yes, Mr. Chairman.

I just wanted to mention that since transportation costs in many households are second only to housing costs, that one other thing we could do is to really promote the use of commuter choice, to help people in their use of transit. I mentioned that we had 9 billion passengers last year. We have the capacity to significantly increase this number, and this kind of tax incentive is very helpful. I know Congressman Wynn is very interested in this, especially in the Washington, DC, metropolitan area, but you have got a great transit program in Chicago, and I do think that could provide some relief for families that we have concerns about.

Mr. TAUZIN. The gentleman's time is expired.

The Chair recognizes the gentleman from Oklahoma, Mr. Largent. Mr. Wynn will be next.

Mr. LARGENT. Thank you, Mr. Chairman.

I want to say I differ a little bit with the gentleman earlier that asked questions. Mr. Richardson—Secretary Richardson said that the Department of Energy hasn't done anything related to energy, and I would say that I want to applaud the Department of Energy and the administration's effort on electricity restructuring because it is something that I think we are all going to feel the negative consequences of not having done anything sooner this summer. And I know that you have been traveling the countryside and warning of potential brownouts. In fact, some of those have already occurred. With the warmer-than-expected spring that we have had both in San Francisco and Detroit, they have had problems. So I wanted to say thank you for your effort, and we will continue to work with you to try to move that forward.

But I wanted to ask you and Mr. Guzy the question of what impact the more stringent environmental requirements have had on supply of petroleum products in this country.

Mr. Guzy, would you go first?

Mr. GUZY. Our belief is that the cleaner gasoline requirements can be fully met and have been historically fully met without any adverse impact on supply of gasoline in the country. We look at the significant involvement that the industry has had in helping us craft this program first through a regulatory negotiation and then through working with us to ensure that there was adequate lead time to ensure that refineries could get up to speed, that the transportation infrastructure for the products would, in fact, be up to speed. We look at how across the country, if you exclude the two areas in Chicago and Milwaukee where we have seen these inexplicable price spikes, the fact is that conventional gasoline is slightly higher in price at the wholesale level than reformulated gasoline but only slightly, and our understanding is that, in fact, even for these two areas there should be adequate supply to meet the consumer needs.

Our belief is, in fact, that the source of the problem here is not the cleaner gasoline requirements at all but that the American people should have some explanation of it.

Mr. LARGENT. So is it your contention that the price spikes are a result of big oil companies profiteering?

Mr. GUZY. Well, that certainly is one possible explanation. That is why Administrator Browner and Secretary Richardson asked the FTC to conduct that investigation. Because we have looked at all of the other issues that possibly could be an explanation, whether it be the pipelines that supply the area, whether it be the changes in technology that the refiners agreed are appropriate for meeting Congress' mandate for cleaner gasoline, whether it be the production of ethanol as preferred locally in these two areas, and none of them in our view can account for the huge, huge price differentials that there has been.

And then when you look at the fact that, as soon as the request for an investigation came in, since that time, since June 15th, the wholesale level in prices have dropped precipitously, some 40 cents per gallon, and there seems to be no change in the underlying factors that would account for that, we are left only wondering whether it is the issue of the kind of prices that large oil companies in fact are charging for their product, and that is why the FTC has been asked to investigate this.

Mr. LARGENT. It seems to me that what you are saying—and I am glad that you reiterated because I think that is exactly what Secretary Browner said before you—or Administrator Browner said before you. And yet I think what you say is really counterintuitive to my way of thinking because, in fact, the number of refineries in this country has decreased by about half, I believe, in the last 10 or so years, and the number of products that they are required to produce has escalated unbelievably as a result of both local regulators and national regulators like the EPA setting down these mandates. And, in fact, in our second panel I think we will probably hear some of the explanation for what you refer to as being

inexplicable for the different variations in prices around the country.

But in the testimony of the second panel this is one of the maps—I know you can't see that, but you can see just from the various colors—these are all the various products that refiners—and, again, we have half the number of refineries in this country than we used to have—have to produce because of either local or national new environmental requirements in terms of what goes in gasoline. And one of those happens to be Tulsa, Oklahoma, which is the district that I represent.

It is a county-wide initiative to meet clean air standards to stay in attainment with the EPA's newer, more stringent air requirements; and they have gone to what is called a Reid Vapor Pressure 8.0 Agreement. Now in order to get that, there is one pipeline that comes up from Texas. They combine two different types of gasoline to produce this 8.0 Reid Vapor Pressure type gasoline that is sold only in Tulsa, Oklahoma. Nowhere else in the country is this gasoline required. There has been a disruption of supply to Tulsa; and, as a result of that, Tulsa has experienced some of the highest prices in the country where we have traditionally always been one of the lower places to buy gasoline.

And so I would say, to my way of thinking, this is a very real explanation of why the prices are higher in Tulsa, is because the new environmental requirements that Tulsa County has entered into to stay in attainment with the EPA has created a supply and demand problem. We are the only place that requires this. The supply is limited, so the price goes up. Don't you think that is a reasonable explanation?

Mr. TAUZIN. The gentleman's time is expired.

Mr. GUZY. We would be, obviously, pleased to work with you to look at the particular challenges that are posed in your district. But I would say where we have looked very closely at that in Chicago and Milwaukee there are in fact no more blends of gasoline that are required this season, this May-June timeframe, than there were in previous seasons. So for the Chicago-Milwaukee price spikes, that cannot be an explanation for why they are occurring. That is why we are left with the request for an investigation, for the FTC to conduct it.

Mr. TAUZIN. Gentleman's time is expired.

The Chair recognizes the gentleman from Maryland, Mr. Wynn, for a round of questions.

Mr. WYNN. Thank you, Mr. Chairman. I apologize if I am covering ground that has been previously discussed, but we have had some parliamentary maneuvers that have kept me somewhat occupied.

With respect to the SPRO, there are a couple of proposals, one to use the existing reserves, the other to create a separate reserve for home heating oil. The argument has always been that, to the extent that we put more reserves out into the marketplace, that foreign oil just basically makes adjustments restraining the market so that it really doesn't accomplish anything, that you still have an inadequate supply. Do you agree with that analysis?

Mr. RICHARDSON. Congressman, basically, yes, although I will say that what we are asking for in the home heating oil reserve,

which is a new proposal, is something that would be used only in supply emergencies, not based on market or prices. Our objective there is humanitarian, in the event of a supply shortage to have 2 million. In terms of the strategic petroleum reserve, the full authority that I have to manage the strategic petroleum I don't have right now because of a failure to reauthorize the legislation that is needed.

Mr. WYNN. If you had it, could you use it to address price problems as opposed to the emergency problems? In other words, the problems that the Northeast has experienced, the problem that the truckers experienced earlier in the spring, could you use that authority to put product on the market?

Mr. RICHARDSON. Ultimately, the President makes that decision, but the answer is, technically, no, Congressman. The law specifically sets national supply emergencies, not pricing issues.

Now, what we also have in this country is low stocks, high demand. So we have a multiplicity of factors right now that are in play. But I think to be absolutely certain, so that we are fully protected, I think it is important we get that full authority which has been still languishing, not in this body but in the other.

Mr. WYNN. If the full authority would not enable you to respond to pricing problems, is there some other mechanism, another type of reserve that ought to be used for these pricing problems?

Mr. RICHARDSON. You know, Congressman, it has been, I guess, traditional in our energy policy bipartisan, that the government doesn't get involved in pricing issues, that we find other ways of protecting the consumers. I mentioned the low income energy assistance, the weatherization initiatives, other ways to soften the blow.

Mr. WYNN. In the absence of a major infusion of funding in the low income assistance, which I am a big supporter of, it seems that the consumers are basically vulnerable to these inexplicable price spikes.

Mr. RICHARDSON. That is right, and this is why we are urging that we make sure that we fund these programs, the weatherization, low income energy assistance.

Mr. WYNN. If your investigation reveals that these price spikes are not in fact inexplicable but are explained by price gouging, what action would you take?

Mr. RICHARDSON. Well, I think this is—

Mr. PITOFKY. That probably is something I ought to field.

If we find illegal behavior, our first step would be to go to court and get an injunction and to stop it. That would be our principal action. And, in addition, it is possible that if there was illegal behavior, some of the money that the sellers accumulated is ill-gotten gains, is illegally acquired gains. If so, I think we would take steps. We would certainly explore whether there were ways to get that money back to consumers. That is awfully difficult in the oil business, but we would look at it.

Mr. WYNN. Could you mandate reductions?

Mr. PITOFKY. No, we wouldn't do that. We don't do that. Our goal is to ensure a free and competitive marketplace. We don't fix prices. We don't roll back prices. We depend on the market.

If individual companies distort the market through conspiracy, then we make them stop. And just to finish, there is a possibility that we could require disgorgement of illegal profits back to the Treasury.

Mr. WYNN. Back to the Treasury but not back to the consumer?

Mr. PITOFSKY. You could try that, but the problem is, how do you show which consumer bought what gas at what price? The record-keeping would be very difficult, but there might be ways in which that could be accomplished.

Mr. WYNN. Let me ask the Secretary one other question. These whole circumstances we have experienced since the spring seems to call into question whether or not we have adequate domestic supplies, adequate domestic production. People suggested environmental regulations, people suggested a lot of reasons. What would be your suggestions with respect to increasing domestic production?

Mr. RICHARDSON. Well, Congressman, you know, the President has a package, \$4 billion in tax credits for energy efficiency, for fuel efficient vehicles, for efficient technologies in homes, factories, residences, energy efficiency initiatives that also combine efforts to save energy. In addition to that, we have a substantial package to help our domestic production.

Specifically, Congressman, you know when oil was \$10 a barrel our domestic oil and gas producers were really hurting. Many were wiped out. In fact, even though it is at \$30 now, a lot of them still need a little boost, still need to get back. And this is why we have proposed a package to assist them, including loans to get back up, including marginal low tax credit, including some tax provisions that make it easier to drill and to explore within the country.

Mr. BARTON [presiding]. Unfortunately, the gentleman's time has expired, and we have got a lot of members. The gentleman from California, Mr. Rogan. I was told it was Mr. Rogan. Mr. Bilbray seems disappointed, but I am told Mr. Rogan is next in line.

Mr. ROGAN. Mr. Chairman, I hope this is the only time during our mutual service in Congress I disappoint Mr. Bilbray.

Mr. BARTON. The gentleman is recognized for 5 minutes.

Mr. ROGAN. Mr. Chairman, thank you for calling the hearing; and I also want to thank our distinguished panel for appearing today. Like some of the other members, please accept my apologies for missing part of the hearing. I think, Secretary Richardson, you more than most are sensitive to what happens when there are a number of procedural votes that call us away.

If I ask any questions that have been asked already, please tell me, and I won't pursue the area, and I will be happy to look at the transcript.

But I especially wanted to ask, first, Secretary Richardson about his statement a few minutes ago that the administration came to the conclusion that ANWR exploration was not in the national interest. Let me share with you just a few facts from the reports that I have read that have caused me to feel that that is not an appropriate analysis; and if I am mistaken in the underlying assumptions, please correct me.

It is my understanding, Mr. Secretary, that the administration is refusing to open  $\frac{1}{100}$  of 1 percent of ANWR to oil exploration, and if that had been opened, that would open the same amount of oil

or would make available the same amount of oil to us as 30 years of imports from Saudi Arabia and that the proposed drilling footprint is only about three square miles on an area that encompasses some 58 million acres of land. And, finally, that everyone from the local Eskimos to workers up there were encouraging this because the Eskimos were saying that they were going to get much more revenue for hospitals and roads. Obviously, the workers would have the motivation for employment concerns. Are those facts and figures essentially correct?

Mr. RICHARDSON. Congressman, I don't usually totally duck questions, but let me just say that this is an issue that probably is best addressed to Secretary Babbitt now because it is a Department of Interior jurisdiction.

I will say, though, that the administration has concluded for ecological reasons that it is not in the national interest to drill at ANWR, that there is sufficiently other areas in Alaska and in the rest of the country that domestic oil and gas can be drilled and explored, and as part of a package there, we have produced a number of tax incentives to help our domestic oil and gas production. There are other parts of Alaska, Alaska Preserve, the North Slope that we have supported drilling, but ANWR, I can get into a statistical—you know, we have these figures, you have those figures, but I don't want to do that, and I think Secretary Babbitt could probably do that much better.

Mr. ROGAN. That is a fair answer. And I want to preface this by saying I am not trying to bait you, and I am not trying to play any game of "got you".

The fact is, as a Member of Congress I sit and I see gasoline prices in my district and around the country skyrocketing. People want to know why, and I am trying to figure out what is the appropriate answer without unfairly pointing fingers. But when I look at those figures from ANWR exploration and I couple that with other figures that have been made available to our committee, such as when the administration began there were some 650 or so oil rigs producing in the United States, there are now only 153, that domestic oil production has plummeted 17 percent, these type of facts indicate to me that there appears to be at least some hostility from this administration to domestic oil production, and ANWR just tends to be one example of that. I would be happy to hear you comment on it.

Mr. RICHARDSON. Well, I don't think there has been hostility. In fact, we have worked very closely together with the domestic oil and gas industry, especially in the last couple of years. We have had deep water royalty relief. I did mention these domestic oil and gas provisions that we just initiated. We did have a number of royalty simplification initiatives.

In your own State, we had that Elks Hill privatization. That involved unusual cooperation with the oil companies. We have had a number of depletion initiatives for small producers. We have had a number of other efforts to improve the technology. The Department of Energy funds many technology exploration techniques that are used for the oil and gas industry.

But you are correct, Congressman, there has been a reduction in domestic oil and gas production; and they were especially hit hard

a year and a half ago when oil was at \$10 a barrel. Regions where I used to represent were hit very badly. And my point here is that, even though oil is now at \$30, a lot of those small independent producers are still hurting. We still need to get them back on their feet, and this is what we are trying to do.

Mr. ROGAN. Mr. Chairman, I see my time is about to expire. Thank you, Mr. Secretary.

Mr. BARTON. The distinguished gentleman from Virginia, the ranking member of the Energy and Power Subcommittee, Mr. Boucher, is recognized for 5 minutes.

Mr. BOUCHER. Thank you, Mr. Chairman. I want to join with others in welcoming these distinguished witnesses today; and I want to say a special word of welcome to our former colleague on this committee, the Secretary of Energy, Secretary Richardson. Mr. Secretary, I understand that you, in response to a question earlier this morning, indicated that the administration would not support at the present time legislation that is designed to restructure the electricity market, which is limited just to what we are calling system reliability assurances and also as a component of that measure would include measures designed to bolster transmission. Would you care to give us something of a formula for what the administration would recommend in terms of legislation for industry restructuring? Would it be sufficient, for example, for us to simply perfect the 1992 Act and facilitate a wholesale market for electricity generation and sale or do we need to take the next step and do those things necessary to create a national retail market at the same time? What is your formula?

Mr. RICHARDSON. Well, Congressman, that is our view to stand-alone reliability legislation. We believe it is not a comprehensive solution. It happened in the Senate, and we believe the approach that this committee has taken, that Congressman Dingell and you and Barton and Bliley, at looking at broader issues—we have got to address the transmission issue. We have got to address the generation issue. We have got to address the capacity issue, interstate transmission systems, the repeal of PURPA, the repeal of PUHCA, all on a comprehensive basis. It is our view that if we don't address horizontal market power what you are going to have is utilities may be able to inhibit the entry of new competition, and this would prevent investments in new power plants and the electricity grid.

We urge you to work with us. We are having potential brownouts and power outages around the country. We need to do this in a bipartisan fashion.

I know Congressman Pickering took the lead in putting together initial legislation. We want to work with you to do this, but we think that it is important that we not just do stand-alone reliability. That will not fix the distribution problems that are inherent in the system.

Mr. BOUCHER. Thank you for the answer. I think you will find a willing audience here to accept your invitation for a larger measure, and I accept your suggestion of what some of the elements ought to be.

As you indicated earlier, we have approved in the House legislation to renew the President's authority to manage the Strategic Petroleum Reserve. The Senate has not acted on that measure. I am



wondering, if we are successful in adopting renewal legislation, if you would be interested in doing something which I would put in the category of a rather clever move. I read earlier this year that your office was perhaps considering this, and I would like your comment concerning it.

We only have about 500 million barrels in the Reserve in round numbers, and it has a capacity of 700 million barrels, and so it is below its capacity rather substantially. Your office had been considering a way to fill the Reserve, essentially at no cost to the taxpayer, and that would be through the immediate loan of some petroleum from the Reserve to companies that are interested in putting that petroleum into the market and then having those companies replenish the Reserve with that amount plus a premium, interest, if you will, at a future point and that premium or interest would be an amount sufficient to fill the Reserve.

I would assume, as a first matter, that you do not have the statutory authority currently to engage in that transaction, given the fact that we have not renewed the President's authority to manage the SPR, and I would appreciate your comments on that.

Second, if you get the authority you need, would the Department be interested in pursuing that kind of approach?

Mr. RICHARDSON. Congressman, I first have to commend Congressman Largent and his leadership on restructuring. I missed his name, and I would never have forgiven myself because of his leadership on it and not because he said some nice things about me, but that is a fact.

Let me just say, right now, the authority for the Strategic Petroleum Reserve, because it has not been fully authorized, is called the Energy Policy and Conservation Act, and a lot of these issues are murky. For instance, I acted on the Strategic Petroleum Reserve 2 days ago on precisely what you describe, which is basically a swap. It is to deal with a dry dock emergency in Louisiana. With Citgo and other energy companies, we moved 500,000 barrels because of that emergency. It was basically an exchange.

So I have the authority to do that. My lawyers felt I did.

For the regional reserve for the Northeast, it is murky; and for use in terms of a national emergency, I just need the full authority to do that.

What you have also described with the Strategic Petroleum Reserve, you can sell off oil or you can swap it. What I think my main job as Energy Secretary is, is to make sure that the Strategic Petroleum Reserve is well managed and is strong. We did, Congressman, fill it up to about 579 with what is called royalty in kind, where we exchange with the Department of Interior barrels of oil. And my objective is to fill it up, and we did fill it up at that time when the price of a barrel of oil was at \$10. So it was a smart decision. It was one of the first things that we did.

I think one of the efforts that I hope this committee engages in is ways together we can make sure that the Strategic Petroleum Reserve is better managed and we can use it more based on market principles. And we can be creative, as you mentioned, but I think the statute does make sense that it should only be used for national supply emergencies, and this is why we have been cautious in using it.

Mr. BARTON. The gentleman's time has expired.

The gentlewoman from New Mexico is recognized for 5 minutes.

Mrs. WILSON. Thank you.

I look with some amusement at some of the statements that the reason for high prices is that "big oil is gouging American consumers." It would sound silly if it weren't said by straight-faced people.

I have been watching both what has been said here today and in the last couple of weeks. It sounds very familiar to me, because I am a mother of young children.

When I walk into the living room and there is a mess on the floor and I ask, "Where did this come from?" the first answer I get is, "I don't know." Which, I think, Mr. Guzy, is the preschool equivalent of saying, "It is inexplicable."

The second answer is, "Well, maybe we should see if somebody came in through the garage and made this mess." Mr. Pitofsky, that is the translation of, "We definitely need to investigate."

Then there is the old standby, "He started it." Usually, when that happens to me at home, I tell my kids. "We should start over on this discussion and always remember that it is important to tell the truth and take responsibility for your actions."

Preschool rules don't usually apply in Washington, and I suspect that is because we don't have adult supervision here. But I think it is time that we stopped pointing fingers and laying blame and saying, "I don't know" and making silly statements like, "the real reason is that big oil is gouging American consumers" and get down to some real answers and real analysis.

If it is so easy for the big oil companies to manipulate the market that we think that this is the only possible reason this can be happening, why did the big oil companies leave the price so low for so long if it was so easy to get a higher price?

Mr. GUZY. Congresswoman, I can't speculate as to what their motives may have been, and maybe it helps to go back to indicate what our understanding is isn't simply saying we don't know. What we have done is done a very careful investigation of the situation to look at a variety of issues that perhaps could be contributors to these price spikes.

After looking at each of those, we have determined that, in fact, they do not seem to be the explanation for it. Whether it be the cleaner gasoline requirements that took effect in June of this year, whether it be the adequacy of supplies, whether it be transmission difficulties, whether it be some patent disputes that may be affecting the industry—and each of these we have looked at and each of these we find have not provided an explanation.

For cleaner gasolines, as I said before——

Mrs. WILSON. It is a straightforward question. And my kids try that, too. If we all talk forever and change the subject, we do okay, but we don't answer the question.

Mr. GUZY. I am attempting to answer the question.

Mrs. WILSON. The question is, if it is so easy for big oil to manipulate these prices, why did they continue with low prices for so long?

Mr. GUZY. I can't speculate about the pricing practices that they have. What I can tell you is the facts that we have and as we know them in this situation.

Mrs. WILSON. Mr. Richardson, I know that you have some energy analysts that look at energy markets and prices and so on. How much do we really know about these micro markets and the fact that, in this current situation, one of the big differences from the 1970's is the disparity between regions? How much do we really know about how these operate and how much—in terms of models and analytical tools and all of these other factors like different kinds of products required and pipelines and surface transportation and all of those kinds of things?

Mr. RICHARDSON. We have the Energy Information Agency, which was created by this committee, which is an independent statistical agency within the Department of Energy that looks at all of these trends and models. And if you want to ask a specific question, I have one of our specialists here on oil, if you choose to do that.

Mrs. WILSON. I guess what I am asking is, are these still simple demand and supply models and are we able to deal with micro environments? There must be factors at play in these smaller markets. What do we know? And are the tools available to look at them?

Mr. RICHARDSON. The answer is, yes, there are tools available. These predictors generally are right, but they are not always right in terms of some of these predictions.

Now, what they do is—what they follow very carefully is gasoline and the oil price nationally and internationally, but they have a capacity to look at international models and look at the Asian market and what is happening with Europe and the effect of the refinery problem that I mentioned in Kuwait and factor it into a model that is more micro and moves into this country.

Mr. BARTON. Congressman Barrett, is recognized for 5 minutes.

Mr. BARRETT. It is a pleasure to see all of you this morning.

I had contact with people from your offices, since I represent Milwaukee and that was the spot where a lot of this began. I understand the comments of my friend from New Mexico and her feeling that there is a lot of finger pointing here, and I can tell you that the consumers in my neck of the woods, they don't care whose fault, they want the prices lower. That is the only thing that matters, and we can argue until the cows come home as to whose problem it is.

I also understand that there have been people in the press and here in Congress who have scoffed at the notion of market manipulation, but I have to admit in this whole dialog there is one paragraph in a newspaper that sort of jumped out of me from my local press. It wasn't a quote. It was a gentleman who represents the industry in Wisconsin, and he was talking about why Chicago and Milwaukee had higher prices than Louisville and St. Louis and these markets. I think it is instructive, because Chicago and Milwaukee are the two communities that exclusively use ethanol-based RFG. Louisville and St. Louis provide sort of an interesting test case because those are the two markets that have a combination of ethanol-based RFG and MTBE-based RFG. In Louisville, it

is a 50/50 mix; and St. Louis, it is 30 percent roughly ethanol and 70 percent MTBE.

And the question that was posed to him was, why are the prices lower in those communities than Milwaukee and Chicago since those communities used ethanol-based RFG as well? The response was, well, the difference in those communities is that there was competition from MTBE.

Now, I say that, Mr. Pitofsky, for your benefit because that really jumped out at me. I thought, wait a minute, we have all of these profit-making companies, and presumably they are all trying to maximize their profits and compete against each other. But the answer that somehow in St. Louis and Louisville they were competing against MTBE but there was no sort of interproduct competition that had been introduced in the other areas made me think and infer from that comment that the ethanol-based producers would act in concert unless they were forced to compete with somebody else.

Mr. Richardson, do you want to comment on that?

Mr. RICHARDSON. Congressman, first of all, to answer your question about the Midwest, and I know that you are very targeted toward Wisconsin, but I think this applies to us, first of all, overall, crude oil prices remain very high, but what is particularly apparent in the Midwest is there is higher demand in the Midwest than the national average. It is about 3 percent compared to 1.6 percent. That is one factor.

The second factor is gasoline inventories. In other words, stock was low going into the summer driving season. In other words, I think the statistic is 15 percent less than last year.

Third, RFG 2 came into the market using ethanol, and no MTBE came into the Chicago-Milwaukee area.

Fourth, there were distribution problems at the start of the season, and I think Secretary Slater mentioned them. The Explorer pipeline shut down. This was a net loss to the Chicago Milwaukee area of 6 million barrels. That is significant.

Now, the question becomes, despite all of that, we could not attribute—after we sent teams into your district, into your city, into the city of Chicago, we could not attribute why there was a 40 cent differential between conventional and RFG 2. I remember our phone call: 40 cents, what is the reason?

I think this is the reason, that the FTC is involved here, without necessarily pointing fingers. I think this is a basic fact that we don't have, and this is a fact that we are searching for an answer. The oil companies just have not explained why this has happened, and this is why I think the FTC is examining this. This is why we are here.

Mr. BARRETT. Mr. Pitofsky, am I missing something here with the St. Louis and Louisville analysis and comparing it to Chicago-Milwaukee?

Mr. PITOFSKY. I don't think that you are. Part of our job is to compare communities where prices spiked up and try to get an explanation as to what is going on here. You suggest one, which is that there was not much ethanol competition. We will look at that. I don't think that it is useful to speculate too much in this area

or rush to judgment. But that is certainly something that we will look at.

In answer to the previous question from Ms. Wilson, why have oil prices have been so low in this country for so long, the answer is competition. Why did they spike up? There are two possibilities. One is that competition somehow was thwarted by private behavior; and the other is that, in a competitive market, there were good reasons why the prices spiked. And it is our job to report back which of those are true.

Mr. BARTON. The gentleman from Arizona, Mr. Shadegg, is recognized for 5 minutes.

Mr. SHADEGG. Thank you.

I am troubled by some questioning that went on earlier, Mr. Pitofsky. You have a basic understanding of economics, I assume?

Mr. PITOFSKY. I hope so.

Mr. SHADEGG. You understand the law of supply and demand?

Mr. PITOFSKY. I do.

Mr. SHADEGG. Ms. Wilson asked a question about gouging. There was a direct reference to gouging earlier here when my colleague, Mr. Stupak, held up a chart and it showed here is the retail price of gasoline and here is the wholesale price and it showed the wholesale price going down but the retail price of gasoline not going down. And he said, how do you explain that? When the wholesale price of gasoline goes down, the retail price must go also down. Why isn't it happening? And every member of the panel said, we have no idea how that could possibly happen. It looks to us—and the line of testimony was, it must be gouging.

You certainly understand and would agree with me that, in determining price, cost is not the only factor, is it?

Mr. PITOFSKY. No, it is certainly not.

Mr. SHADEGG. If in the course of your study you find that the demand remained constant and supply fell, that prices not only could stay constant but continue to go up, retail prices could continue to go up in order, for that matter, to hold down demand and to reflect the fact that supply has gone and demand has remained constant—I am puzzled that not a single member of this panel said that. And it was all, gee, it looks like gouging, but we will get into it. Certainly you would agree if you find supply went down but demand stayed constant, that would explain that differential, wouldn't you?

Mr. PITOFSKY. Yes. In my opening statement I went out of my way to say that we are not just going to look at prices but also at the levels of inventory and the supply question and the production question. I completely agree with you that you have to look at the price—

Mr. SHADEGG. I have to move on. I apologize. I appreciate that point.

Mr. Guzy, I want to go to a couple of other issues. The EPA pretty well acknowledges through all of its documents that there is a 5 to 8 cent per gallon cost of RFG, reformulated gasoline.

Mr. GUZY. That is correct.

Mr. SHADEGG. Ms. Browner seemed to imply because the retail costs in some places of RFG is a penny below the price of nonRFG, perhaps there is no price differential in the cost of its production.

Mr. GUZY. That was not intended to be the implication of her statement. It shows that the RFG is able to be produced and supplied in an acceptable fashion to consumers.

Mr. SHADEGG. The experts that I have heard from said, look, it is more difficult to produce the base gas. And that is why, when we converted to produce the base gas for the RFG for the June 1 deadline, supply went down and therefore costs went up. You don't flat reject that premise? You don't say that is impossible, that couldn't have been a part of the factor?

Mr. GUZY. We are aware of the length of time that the industry has had to prepare for the change.

Mr. SHADEGG. It could have been in the transition, June 1, a lower production and therefore a lower supply and that was a contributing factor?

Mr. GUZY. That could be a contributing factor, but you have to ask the question, why did that occur, given the amount of lead time that the industry had?

Mr. SHADEGG. One other point that Ms. Browner made, she said granting a waiver could cause costs at the pump to go up. Yet the waiver wouldn't mandate the sale of nonRFG gas. It would simply say, you may sell RFG gas or nonRFG gas, in which case I am at a loss to understand how granting a waiver could cause the cost to go up.

Her implication was, since there is already RFG in the pipeline and in the trucks and tanks, they would have to spend money to take it out of those trucks. There is no reason to believe that they would do that. They would deliver what they have left of RFG and add on top of it nonRFG?

Mr. GUZY. We have talked to refiners, and what they tell us is, were EPA to grant a waiver, many of them, their practice would be to try and sell the slightly less costly to produce conventional gasoline and hold in reserve the reformulated gasoline.

Mr. SHADEGG. If they did that, prices would go down?

Mr. GUZY. And the effect would be to have some very severe and unpredictable supply disruptions for conventional gasoline. What it would also likely mean is that the distribution of that conventional gasoline would be over an area where it now currently is, and that could lead to cost spikes as well.

Mr. SHADEGG. Mr. Secretary, one of the issues here has been what is causing this cost. You have a publication, a primer on gasoline prices that says, long term, years 2000 to 2020, it states tighter environmental standards on the quality of gasoline will also be a factor in higher prices. In your testimony here today, you are not saying that that is not a factor in the cost, are you?

Mr. RICHARDSON. No. I said, Congressman, with respect to the Midwest, there are some price differentials, 2 to 3 cents that are involved. I did not say it is not a factor.

Mr. SHADEGG. And you are not disavowing your statement here in the brochure?

Mr. RICHARDSON. I am not.

Mr. BARTON. The gentleman from Texas, Mr. Hall, is recognized for 5 minutes.

Mr. HALL. Thank you, Mr. Chairman.

Mr. Pitofsky, you talked about prices being lower because of competition. The competition that we see in the oil patch—I think the facts are that we are not allowed to compete, Delta Drilling in Tyler, Texas, for example.

And my friend who has reason for concern, Mr. Barrett over in Wisconsin, he talks about a fair price. I fear that we are not going to get a fair price until we get some stable oil prices, and that is what we need because we need incentive for people to drill.

The rhetoric has escalated to a fevered pitch, with Democrats blaming Republicans and Republicans blaming Democrats and consumer groups blaming the oil companies. Frankly, I think the low prices of last year when we had nobody crying out to us, they were every bit as much of a market signal that something was wrong as the relatively high prices that we are seeing today is a signal to us.

Energy States get very little attention by the Congress. There are 10 of us. Forty other States use it, and we are outvoted four to one when we try to get stable prices. Little guys have to find the oil and gas; big guys buy it. Little guys have to borrow money to do it. The bank won't talk to them, even when it is \$30 a barrel, because there is no stability.

I think I have some very simple questions to ask. A lot can be answered with yes or no. I might start with my friend Mr. Richardson. Who sat right here for many years. Bill, do we need larger drilling options? Yes or no?

Mr. RICHARDSON. Yes.

Mr. HALL. Do you remember or do you remember studying in history how in the late 1930's Cordell Hull and Henry Stimson forced Japan to go south into Malaysia for energy?

Mr. RICHARDSON. Yes, vaguely.

Mr. HALL. But you passed that course, I know. They forced Japan south for energy when they cutoff their energy, and what ensued? War. That is an easy yes, isn't it?

Mr. RICHARDSON. Yes.

Mr. HALL. Do you think Hitler went east into Ploesti oil fields for energy? Was he looking for oil and gas?

Mr. RICHARDSON. Yes.

Mr. HALL. Well, energy is the thing that people will fight for. Countries will fight for energy, won't they?

Mr. RICHARDSON. Yes.

Mr. HALL. And this country sent 400,000 or 500,000 over to a country not because we loved Kuwait but to keep a bad guy from controlling over half of the world's supply of energy. Those are all easy yeses. Now what are we doing about it?

Let me ask you about protecting the environment. We want to protect the environment, but is there going to be a time when we put protecting our country above even protecting the environment? And wouldn't a ship laden with American soldiers and sailors—we would fight for energy—look a lot worse than an offshore drilling rig?

Mr. RICHARDSON. Yes.

Mr. HALL. And can you envision a time when we would have to do that, and how far away are we from doing that?

Mr. RICHARDSON. Congressman, I think the key—we can have sensible energy development and protect the environment. I think we are doing that. I think we have to strike a balance, and I think you know how to do it, too.

Mr. HALL. The gentleman from California suggested a moment ago that for just a small percent of 1 percent of drilling in ANWR or on the Federal lands or offshore or on the North Slope could relieve our situation immensely. That is also true, whether or not you agree that they ought to do it or not. It would, in time—it is not an overnight solution, but it would, in time, give our people a chance to produce and find a stable supply of energy?

Mr. RICHARDSON. I think I can say that, yes, it would increase production in this country but at the risk of what we consider serious ecological damage. And we believe that there are parts in this country that we can do domestic production more effectively—in your State and my State, in the Southwest.

I think we need more technology. I think we need—I have been with you, and I have seen those independent producers. We have a package to give those marginal well gas producers a little tax relief to deal with some price fluctuations at \$10 barrel and G&G expense at Legg Reynolds. If we concentrate on helping our oil and gas people right now, we can deal with some of these issues.

Mr. HALL. That is part of the Wes Watkins package, and we ought to adopt it right now.

Mr. RICHARDSON. The President is for it, and we are for it, yes.

Mr. HALL. I have been approached by some Californians who are owners of the so-called California Offshore Oil and Gas Energy Resources, and I think you are familiar with them. They are interested in swapping the Federal lease interests they have off the California coast for bonus credits to be used in the central and western Gulf of Mexico or offshore. Now if California doesn't want that production and they don't want to take that position and the leadership in the field of energy and Texas is willing to, why not do that? Why not approve those? I think the Minerals Management Service oversees the production of offshore oil and gas reserves, and what would hold them up from doing that?

Mr. RICHARDSON. Congressman, I am going to duck your question. That is Interior. That is Federal. I think maybe you ought to talk to Secretary Babbitt. I am not familiar with that swap issue, with that proposal. If I can get back to you.

[The following was received for the record:]

1. DOE does not have a position on the proposal by the California Offshore Oil and Gas Energy Resources group to trade leases that they hold on the OCS off California for bonus credits to bid on leases in the Gulf of Mexico.

2. There is precedent for this type of "swap", however. In the past, MMS has traded existing leases that could not be developed due to some restrictions for reduced royalty rates on future leases for the companies in question.

Mr. HALL. Leases have been in existence for 20 years without any commercial production because of continued opposition from the people in California. Maybe the people in Texas don't have that opposition.

Mr. BARTON. We expect a vote on the rule almost any minute. I have sent Congressman Bilirakis over to vote and come back immediately so we can continue the hearing. We want to give the



members a chance to ask a second round of questions, then we will take a lunch break.

The Chair is going to recognize himself for a second round of questions.

Secretary Slater, I want to start off by asking you a question. Do you think if we restricted all of the oil production in the United State, including Alaska, and said it could only be used for gasoline and if somehow we could set up our refineries so that they produced 100 percent gasoline from oil, would we produce enough oil in this country to fund all of our transportation needs for gasoline and aviation fuel?

Mr. SLATER. Probably not.

Second, even beyond the issue of the quantity there, we really, I think, have almost limitless opportunities when it comes to looking at alternative fuels. One of the enjoyable and significant successes that we have experienced, Mr. Chairman, working with the automobile community, is that we have actually produced prototypes of automobiles that will get three times the fuel efficiency, and Ford Motor Company is talking about mass producing those automobiles in the 2003 model year.

Mr. BARTON. The reason I ask the question, the primary reason we are doing this particular hearing today, is because gasoline prices have gone up more in the Midwest than they have in the rest of the country; and our citizens, our constituents, want us to do something. But facts are facts. We use about 19 million barrels of oil a day in the United State. We only produce about 8 million barrels a day.

Mr. SLATER. That is correct.

Mr. BARTON. For transportation fuel purposes, we use about 12 million barrels a day. So even if we use all of our oil just for transportation purposes, we would still have to import 4 million barrels of oil a day. And, actually, since you only get about 66 percent gasoline from a barrel of oil, we would have to produce—we would have to import about 6 million barrels. So under any scenario, we are going to be importing oil into this country.

That brings us to a much larger question than why gasoline prices are high in the Midwest.

When I asked my first question to Secretary Richardson about how many quads of energy that we produce in this country, he said that he would get back to me. We produce about 73 quadrillion BTUs of energy. We consume about 97, so we have a 24 quad shortfall that we have to import.

The real policy question today is, what is the United State government doing to minimize imports, to minimize importation of energy? We cannot be self-reliant in oil production. Nobody that I know of says that we can get oil production up to 19 million barrels a day. I think the peak has been around 10 or 11 million barrels a days, and it is down to 7.5 to 8 million barrels a day.

We ought to be focusing on what our national policy is to minimize importation of energy, and that is why I asked the question to Secretary Richardson, what we have done as a country the last 7 or 8 years under the Clinton Administration to maximize understanding the environmental impact of our energy? And I come to the conclusion—and it is a conclusion that is just mine, I don't say

that it is a fact—we can do much more with nuclear power and natural gas and much more in clean coal technology and much more in solar and all of the other alternative energies, and we are not doing it.

Now, Congressman Stearns, who was here earlier, had the budget review for the DOE for the budget submission for this budget year. And in this book it shows that the Clinton Administration request for hydrocarbon resources for R&D went down. It didn't go up. It went down.

I am going to ask again, and this is really—we hate to pick on Secretary Richardson, but he is the Secretary of Energy. Does the Clinton Administration share the subcommittee chairman's view that we ought to be trying to find ways to shrink that gap between producing 73 quads and using 97 quads?

Mr. RICHARDSON. I fundamentally disagree with some of your budget numbers.

Mr. BARTON. They are your budget numbers.

Mr. RICHARDSON. You need to pass them, and this has not happened in the last 7 years.

Mr. BARTON. The Clinton Administration could at least request increases.

Mr. RICHARDSON. We have, especially in the area where I explained, in the coal area, because of a postponement of two generation plants until the next fiscal year—

Mr. BARTON. So this budget book is wrong?

Mr. RICHARDSON. No. I don't want to get into a statistical dispute with you.

Mr. BARTON. These are your numbers.

Mr. RICHARDSON. I did find out your quad answer.

Mr. BARTON. According to my chart, it is 73 quads—which I knew at the time.

Mr. RICHARDSON. Your quad answer, a few billion or trillion here is accurate because our Energy Information Agency tells us, in terms of consumption, that the January-February average of this year is 16.6 quadrillions of BTUs. Now the production for this same period is 11.3 quadrillions of BTUs. The difference is net imports and stocks, inventory changes.

Mr. BARTON. That is on a monthly basis, not an annual basis. Just to show you that I understand what you are telling me.

Mr. RICHARDSON. You are a very smart man.

I think the solution to what we are trying to get at is we need to boost domestic production, and my point is that we have some proposals out there that you need to approve.

Mr. BARTON. My time has expired. I need to recognize Mr. Sawyer.

But the DOE Energy Outlook, which is another document that your Department puts together—I actually read these things sometimes. Our production is increasing about 1 half percent a year. Our consumption is increasing about 2 percent annually. So our consumption is increasing 4 times faster than our production, and if we don't change that in some way, there are going to be a lot of hearings about why prices are going up. Because if you are not producing it domestically and you have to import it, the nations that we import our energy from—and they may be our allies and

friends, but they don't have the same political requirement to minimize costs and prices. That is a pure fact.

Mr. RICHARDSON. The problem with the world—you have the world consuming 75 million barrels per day and producing 73. What we tried to do, and I think successfully, is move the production up with some of these countries.

Mr. BARTON. My good friend from Ohio has waited. We will continue the dialog. The distinguished gentleman from Ohio, Mr. Sawyer, is recognized for 5 minutes.

Mr. SAWYER. Thank you, Mr. Chairman.

Mr. Secretary, if you would like to finish your answer to that, I would be pleased to give you the time to do so.

Mr. RICHARDSON. No, I am okay, Congressman.

Mr. SAWYER. You and Secretary Slater have mentioned a couple of ways that we can make a difference in our fuel consumption. Let me mention one that is enormously important.

The appropriate inflation of tires makes a huge difference in fuel consumption, and simply checking your tires once a month not only decreases fuel consumption dramatically but it increases the life of a tire in a way that probably doesn't serve the tire industry, which I have represented for some time as well, but would nonetheless be good for the energy policy of this country.

Secretary Richardson, you were asked by my friend from Michigan awhile back about oil from Alaska. If I recall correctly, it seems to me that in 1995 one of the first acts of the new Congress was to insist on the sale of oil from Alaska, previously limited out of the Alaska pipeline to other countries. I think it was Japan those sales were dominantly made to. So that those sales were done as a product of the work of this body as much as anyplace else. Am I not correct about that?

Mr. RICHARDSON. You are correct. And when we talked about the clean air issue in 1990—I was with all of you here when we passed the Clean Air Act, and we put June as the date. I remember that. I don't know whose amendment it was, but I was involved in that reformulated gasoline issue. So the administration is acting like any administration on the mandate from Congress. I am not trying to blame—June is the date that was fixed by the Act.

Mr. SAWYER. Let me say that I like to think that I have something to do with this whole restructuring struggle as well.

Mr. RICHARDSON. I should have mentioned you. Do you want me to do it again?

Mr. SAWYER. That is okay.

I yield back the balance of my time.

Mr. BARTON. The gentleman from Florida, Mr. Bilirakis, is recognized for 5 minutes.

Mr. BILIRAKIS. Thank you. I came back because I wanted to get in this second round.

Mr. Richardson, Mr. Secretary, you are from New Mexico. I think you have an understanding of the oil depletion allowance even though it is something that existed before you were very old. Do you believe in the oil depletion allowance? Should we reinstate it? We are talking about production.

Mr. RICHARDSON. Congressman, I would have to consult with higher beings before I answer that. Energy policy is made by the President. There are a lot of people participating—

Mr. BILIRAKIS. But you are here representing the President, and you have a personal opinion, too.

Mr. RICHARDSON. One of the things that I found, Congressman, which means that the best job I ever had was sitting next to you, is that when I make statements now sometimes—and this really worries me—markets move, and it makes me a little uncomfortable. So even giving you my personal view—I would be pleased to come back and give you an answer on that.

[The following was received for the record:]

1. Yes, I do support the oil depletion allowance. This is a common tax provision for nonrenewable resources, such as oil and natural gas, to account for the loss in value of a resource asset as it is depleted through production.

2. The oil and gas industry do have the depletion allowance available to them in the Federal tax code.

3. Currently, major integrated oil companies are allowed to use cost-based depletion, while independent companies are allowed to use either a cost-based or percentage depletion allowance. The percentage depletion allowance is 15% of gross revenue from a property subject to net income limitations on how much depletion can be claimed for tax purposes in any year.

Mr. BILIRAKIS. I think it is critical that we know the administration position. Because, apparently, it has been included in tax relief legislation in the last couple of years or so; and it would be interesting to know the administration position on that. If we are talking about doing something about production in this country and encouraging it, I think we ought to seriously take—

Mr. RICHARDSON. We do have a number of other initiatives which I will be glad to brief you on domestic oil and gas production.

Mr. BILIRAKIS. I studied petroleum engineering. I had a professor that kept harping on it. I guess he could see what was coming downstream.

Mr. Pitofsky, you said many times, and I agree with you, the job of the Commission is to ensure free market, free competition, fair competition, et cetera, et cetera. And then you also said, if individual companies distort the market, then we make them stop. I think those are kind of your exact words.

Well, you are in the process now of trying to determine if individual companies have distorted the market or are in the process of distorting the market. Do you have that data available to you?

Let me just expand upon that, and maybe I might ask Mr. Richardson at the same time. Is certain reporting data required of the oil companies in terms of production, costs of production, in terms of refinery costs all of the way down from the time you get the oil from the wellhead and natural gas from the wellhead to the point that it gets to the consumer? Is that data available on a regular, routine basis? I am not talking about regulation here now or anything of that nature, but I am talking about data that would be available so that Mr. Pitofsky's people can readily get at this problem and come up with some sort of an answer sooner rather than later. And if it isn't available, should it be?

Mr. PITOFSKY. The oil industry is remarkable in the extent to which data is available. Certainly, data on prices and I think data on output. I am not sure about cost because that is proprietary.

Mr. BILIRAKIS. But that is significant to your investigation.

Mr. PITOFISKY. Absolutely.

Mr. BILIRAKIS. Somewhere along the line you are going to have to come up with that information.

Mr. PITOFISKY. We have already worked with the State AGs, EPA and the Department of Energy. We have a lot of information, but we need more. We have issued subpoenas, and I assume that we are going to get the information that will help us to understand why this price spike has occurred.

Mr. BILIRAKIS. You know, someone was saying yesterday on the floor that oil and natural gas, natural gas that we use in our homes and buildings and the gasoline that we move from one point to another, is as much a public utility as electricity and whatnot that we use to heat our homes and cool our homes. And even though we are talking up here about deregulating electricity—some are not as keen on that as others—but it is certainly occupying an awful lot of our time. I just wonder if maybe the oil production people are maybe not forcing us almost to consider regulation. That is a nasty word—regulation. Any comments?

Mr. PITOFISKY. I hope not. I really believe that deregulation has served the country well. There are people who take advantage occasionally of deregulation. They enjoy the old world where price fixing was going on, and you have to crack down on those people. But I am not enthusiastic about regulating price and entry. I don't think that it has worked well. Sometimes you need it.

Mr. BILIRAKIS. I am not suggesting it, but I did want to get some idea on data and whether or not there should be more required to be furnished. That is something to think about, Mr. Chairman and Mr. Secretary. Thank you.

Mr. BARTON. I thank the gentleman from Florida.

I am going to try to get the three members still here, and then we are going to excuse this panel and take a break.

We go to Mr. Barrett from Wisconsin for 5 minutes.

Mr. BARRETT. Thank you.

Last night I spent some time, and this morning as well, going over the minutes from the Phase II RFG Implementation Work Group. This was a group that was comprised of employees of the EPA, I assume some employees of DOE, industry representatives, some people from the States.

And I went through the minutes of all 12 meetings—the group met 12 times: four times in 1997, four times in 1998, four times in 1999—and I did that because what I felt all along, again referring to the situation in the Midwest, was that somebody was asleep at the switch or else there is funny business going on here. As I went through, I was looking for any evidence or any discussion of what was going to happen to the price of this gasoline.

I will say—and, Mr. Richardson, Barry McNutt from your office in September, 1997, said, prices are volatile; and he also said, in October 1998, that the supply looks tight. But those are the only two real references in 12 different meetings by anybody attending those meetings that made any reference at all to the price situation.

I raise that because, at the same time, I look at a press release from Tosco Corporation this year dated April 25, and it states, “Re-

fining margins to date in the second quarter are excellent throughout our system. Our major maintenance work for the balance of the year is not significant. Low inventory levels in the U.S. and throughout the Atlantic basin, combined with more stringent gasoline specifications, will, we believe, result in a continuation of strong refining margins."

I read that to say that the oil companies knew that they were sitting in a great situation. Supply is tight. They are about to enter into a new program where the consumer in these two areas is going to be forced to purchase their product. Yet, in the 12 meetings, nobody from industry ever mentioned this, at least as reflected here. And I am thinking, what is going on? They are part of this working group to make sure that this program is going to take off successfully, and there is just a complete silence on this issue. Then, all of a sudden, everything hits the fan; oh, those are just market forces.

Again, since the FTC is doing this investigation, I think it is important to know why at those 12 meetings, and maybe there are verbatim transcripts, I think it is important to look at that. That is my criticism of the industry.

But at the same time, to the EPA, I have to say, how come nobody is looking at this? And if we are going to go into this program next year, are we going to see the same thing next year, Mr. Guzy?

Mr. GUZY. Congressman, I think you have a very important observation there, and it is that not only was there extensive lead time for the industry and extensive consultation with the industry on the appropriate formulation of the product to bring to the market, but, in fact, there has been extensive consultation and work with the industry to ensure that implementation would occur smoothly. And throughout that work, this issue of some kind of mismatch between the supply and the demand, any issue of the difficulty of providing boutique products, any of these claims that we are now hearing were, in fact, not raised.

That certainly informed the administrator's judgment when she sent a letter and requested the investigation from Chairman Pitofsky and the FTC.

Mr. BARRETT. If DOE is coming in and saying prices are volatile, supply looks tight, why didn't EPA ask these questions? I can't let you off the hook entirely here.

Mr. GUZY. The implementation effort is a collaborative effort administration-wide. We work closely with DOE and did to be able to address these issues.

But the other important point and question to ask is, on the back side, why have prices been able to come down so precipitously after the initiation or the request for an initiation of an investigation without any fundamental change in the underlying issues and conditions? And that is something that has us very concerned, and we believe that there should be appropriate answers to that as well.

Mr. BARRETT. Since it is a program that the EPA administers, don't you think that the EPA had some obligation to make sure that supply was adequate? They were sitting on their hands, not saying a word, but nobody asked them.

Mr. GUZY. We did a survey throughout this period leading up to the May 1 and June 1 dates for initiation of this program this year

of the industry and found throughout those contacts that the supply issues were never raised. We were assured that there was adequate supply.

Mr. BARTON. The gentleman from Michigan, Mr. Upton, for 5 minutes.

Mr. UPTON. Thank you, Mr. Chairman.

As I listened to the testimony this morning, there were a couple of things that I noted that were a little conflicting. I want to go over those statements.

Mr. Pitofsky, in your statement you said on page 5 these regulations, referring to RFG, may have led to abnormally low inventories.

Mr. Richardson, you said a little earlier that stocks were low going into the summer, perhaps as much as 15 percent less, I presume, from the year before. Yet Ms. Browner, when she testified before she left—and on page 7, it says, the supply of RFG to the Midwest has increased this year over last year. In fact, for the month of June, refiners expect to supply 650,000 more barrels of RFG this year than last year. EPA is saying we have more. The FTC and the Department of Energy are saying that we have less.

Mr. RICHARDSON. Congressman, I was referring to the Midwest.

Mr. UPTON. Right. That is what EPA was referring to, the supply of RFG to the Midwest has increased this year.

Mr. RICHARDSON. I don't think that there is an inconsistency here.

Mr. GUZY. We have also noted that there is an increased level of demand in the Midwest and other parts of the country this year as well.

Mr. UPTON. As much as 100,000 barrels per 10-day cycle? That is what Ms. Browner said in her statement. I don't know how that comports with the earlier testimony.

Mr. PITOFSKY. My statement was that they may have been lower, and one of the things that we will find out in our investigation is the levels of inventories at the time this new program went into effect.

Mr. UPTON. I would be interested in getting the results of what you find out.

You indicated that you are working with the State Attorneys General, I presume one of them is Michigan, and I have a lengthy letter I know from my State Attorney General to Marathon asking for information by the end of the week. I presume that you are working very closely with her; is that correct?

Mr. PITOFSKY. I am sure we are, yes.

Mr. GUZY. The figures cited by the administrator were for the entire month of June, and our understanding is that there was some significant additions of supply through—pipeline supply that came later during this month period; and the fair question is, why was that supply not provided earlier on if stocks were low in the area?

Mr. UPTON. I have one more question. Mr. Richardson, one of the advantages of when you left this Congress was that you are no longer playing for the Democratic baseball team, particularly at third base where you are quite a slugger, and I remember you put a tag on me sliding into third, and I don't think that they have won since you left.

I would like to think that the decision in March by the OPEC nations was somewhat responsible because of the Gilman resolution that we passed here in the House trying to provide a little more clout to the administration in terms of ramifications if they did not increase their supply. What can we do before they meet in September to provide you a little larger baseball bat like you had when you played on the Democratic team?

Mr. RICHARDSON. Work with me before you do an initiative, a bill. I think there are ways that we can work together and have a unified strategy. I think it is important.

Mr. TAUZIN [presiding]. There are votes on the floor. Mr. Bilbray will be the last for this panel, and we will dismiss you with our great thanks for your patience. Then we will recess until 10 minutes after the last vote on the floor in this series and take up our second panel.

Mr. BILBRAY. A question to the Secretary of Energy. Bill, you know my constituents in San Diego are complaining about the immense heat. We are not used to that heat. We have this local brownout threat all through California. The debate surrounding the national electric restructuring legislation is now centered around two core issues, transmission and reliability. As we have seen what is happening in California, those two issues are intertwined and—as we face shortages in transmission and generation capacity.

But what about the other two issues that go hand in hand, reliability and transmission, interconnection and distributed generation, which is a fancy name for allowing small, innovative ways of getting onto the grid and providing cleaner, smaller, more efficient energy in the system. How do you see that interrelationship as we package this issue?

Mr. RICHARDSON. We are for it. Distributed generation is competitive. It is good. We think it should happen. We think that distributed generation would flourish under competition, and would be ideal for your region in California.

But I just want to stress, since I have this committee here and I have a lot of legislators here, it makes sense to have a comprehensive bill. Don't just give us reliability. We need to deal with generation and transmission, with PURPA and PUCA, with renewable energy, with distributed generation. We need to deal with this comprehensively.

Mr. BILBRAY. Let me say that transportation and EPA, those of us in California, you know that we have put new fuel formulas in, and we have seen these spikes every time. I want to know, how much are you involved personally or your staff involved in trade decisions, embargo decisions? How much are you integrated into those decisions? And let me tell you why. Let me tell you why.

The administration announced that they were pulling the embargo in Iran on caviar and Persian rugs, but not on oil. I know that my average working class citizens need that caviar and Persian rugs, but why was oil forgotten down the line? It seems with all of the rhetoric about caring about the working people of America, the trade relationship was not only absurd from the working man's point of view but ridiculous in terms of needing energy and oil.

Mr. RICHARDSON. Our relationship with Iran is not that good.



Mr. BILBRAY. It is good enough to buy their caviar.

Mr. RICHARDSON. There is a difference with national security, commodities and caviar. We are still concerned about Iran's support for terrorism and their weapons of mass destruction.

Mr. BILBRAY. We will buy their Persian rugs, but we won't allow our people to buy their oil?

Mr. RICHARDSON. There has been an improvement. We want to have a government-to-government dialog, but Iran has not chosen to do that. The Secretary of State I think very skillfully opened the door and started with those products. But getting into energy, that is more serious.

Mr. BILBRAY. Bill, you know where I come from, a working class background. To the average citizen out there, it looks like the people who are lobbying for trade, for the embargo to be lifted, tend to be those consuming or selling the product, and that the priority looks like caviar and Persian rugs are getting more sensitivity in the administration than the oil supply for American consumers. I am just telling you that it looks terrible. And, as the Energy Secretary, I hope you are saying, we are not burning Persian rugs to generate our economic prosperity, but we are burning oil. I ask that they be more sensitive to our energy demands when they start figuring this out.

Mr. Chairman, I appreciate that. Let me say to the Transportation Secretary, trip reduction programs are something that the EPA and Transportation is looking at.

Mr. SLATER. Yes.

Mr. BILBRAY. We have flex time as one of our great successes in California. Twenty percent of the fuel used for commuting can be reduced with flex time. The State of California just outlawed flex time by requiring that anything over 8 hours has to be paid overtime, no matter what. What is the EPA's and what is the transportation's attitude about a State or local government requiring an employer to pay more to implement the flex time strategies as opposed to the old 8 hours a day, 5 days a week, rather than going to the 10-4?

Mr. TAUZIN. Speaking of time, we are out. The gentleman can respond.

Mr. SLATER. I had a great time last week in your fine city with the major transit grant, and I look forward to going back, and it is all designed to give us the kind of choices we need as we remain the most mobile society in the world.

Mr. BILBRAY. Government needs to give the consumer choice, not just the private sector.

Mr. TAUZIN. Thank you Chairman Pitofsky, Mr. Guzy, your boss, Secretary Slater and Secretary Richardson. You do us an honor and obviously maintain our Constitution when high-ranking officials of the Cabinet and the agencies come and discuss these issues. We certainly appreciate seeing you.

We hope, frankly, whatever flows from this hearing and whatever comes out of the investigations, that as soon as possible we can rationalize these markets so Americans won't have the great shocks to deal with in the future. Thank you very much.

The hearing stands in recess until 10 minutes after the last vote in this series.

[Brief recess.]

Mr. TAUZIN. The committee will please come back to order.

What I would like to do is assemble the second panel. We are going to try to complete the testimony this afternoon. Other members will be arriving in due order from the floor and we have I think about an hour where we can take testimony.

Let me remind all members that it will be very, very helpful if the members of the panel would keep in mind that your written statements are part of our record, so I will ask you to please not spend time reading them to us. What I would like you to do is spend the 5 minutes you have just hitting the highlights, if you have a demonstration or some chart or some way that you want to demonstrate what are the main points that you want to make in your testimony.

You can see, when members arrive, Q and A takes quite awhile.

I will begin by introducing our second panel, Mr. Justin D. Bradley, Mark Brown, J.L. Frank, Roger Gale, Mark Gerken, David Nemptzow, Ross Pillari, Michael Ports, and Jerry Thompson, Senior Vice President of Citgo Corporation. Now we will hear from the industry.

We will begin with Mr. Justin Bradley. If you can, summarize, and keep your mind and eye on the little lights.

**STATEMENTS OF JUSTIN D. BRADLEY, DIRECTOR, ENVIRONMENTAL PROGRAMS, SILICON VALLEY MANUFACTURING GROUP; MARK H. BROWN, EXECUTIVE VICE PRESIDENT FOR ASSOCIATION AND CLUB SERVICES, AMERICAN AUTOMOBILE ASSOCIATION; J. LOUIS FRANK, PRESIDENT, MARATHON ASHLAND PETROLEUM, L.L.C.; ROGER W. GALE, PRESIDENT AND CEO, PHB HAGLER BAILLY; MARC S. GERKEN, PRESIDENT, AMERICAN MUNICIPAL POWER, OHIO; DAVID M. NEMTZOW, PRESIDENT, ALLIANCE TO SAVE ENERGY; ROSS J. PILLARI, GROUP VICE PRESIDENT OF MARKETING WORLDWIDE, BP AMOCO; MICHAEL PORTS, PRESIDENT, PORTS PETROLEUM, INC.; AND JERRY THOMPSON, SENIOR VICE RESIDENT, CITGO PETROLEUM CORPORATION**

Mr. BRADLEY. Thank you, Mr. Chairman and members of the committee. My name is Justin Bradley, Environmental Director for the Silicon Valley Manufacturing Group. We are 175-plus member companies started in 1977 by David Packard and other high tech leaders in Silicon Valley in response to the energy crisis that was happening at that time.

That issue was dealt with, and for a long time it wasn't on the radar screen for our organization; and it is in the last quarter it has come to our attention, in large measure because of Secretary Richardson alerting us about potential outages and, of course, weather-related happenings that have brought it to our attention more forcefully.

A little more about Silicon Valley. We represent one in four of private employees in the Valley of 250,000. That is a \$150 billion local economy. One-third of the Nation's venture capital is expended in the Valley, and in terms of productivity, \$300,000 per worker compared to \$200,000 nationally. So things are working very well, and we are concerned about energy and energy reli-

ability jeopardizing the habitat, for what is happening in many other parts of the country much like it is there.

What I want to do is focus on something that I brought with me. This is the Silicon Valley Business Journal and in it are three articles which illustrate what we are talking about. And there is a good news-bad news aspect to each one—\$800 million data center, 2 million square foot what they call an “Internet hotel,” full of servers.

The good news is, it is a great investment; it makes the U.S. more of the hub for the Internet and e-commerce making it happen. The bad news is that it uses 10 to 12 times as much energy as a regular facility. This was not foreseen when energy deregulation happened. This is the nexus that we are dealing with today.

The good news is that our economy is growing tremendously. The bad news is that we had not planned for the energy that it takes to deal with 2-million-square-foot facilities for computers and peripherals and the cooling that it takes to make these things happen.

The next article is, the Maine Governor came and visited us. The good news is, what we are is an incubator for a lot of things that happen in the rest of the country. So if we are dealing with the issue, it often happens in other parts of the country. If we solve things where we are, it benefits the country as well.

The one that we don’t like in the middle, more blackouts predicted this summer. Yesterday Silicon Valley—the State of California had a Stage 2 alert. That is the third one that we have had in the last 5 weeks. We are not used to this. In June, on June 14, we had rolling blackouts. Those are unplanned removal of customers from the grid. It affected over 100,000 customers.

If I may just mention who some of those are: Apple COMPUTER, Cisco, AMD, Selectron, some of those were affected. They were calling asking what are we doing about energy here in the Valley.

We are looking at market-driven solutions that we hope can be addressed from this point of view. Others like Sun and HP did voluntary cutbacks of their power and there are many others.

Just a few facts to give the committee an idea of the connection between the Internet e-commerce, and just to remember the “e” in e-commerce is energy; many don’t remember that. It is dependent on the electrons getting there reliably.

We have only begun to understand how much energy is needed to meet the digital economy’s needs. A Palm Pilot has the potential to reach the Internet, and it would appear that the energy needs are the batteries, but if you are connected to the Internet, it has the energy equivalent of a refrigerator. One-third of the power in your home goes to your refrigerator.

As we proliferate new technology, we need to provide for it. A laptop, it is not 150 watts to run that; if you are Web surfing, it is 1,000 watts. I already mentioned server farms. Eighty percent of the Internet goes through the United States, and a large portion of that, through Silicon Valley; 200 million computers in the U.S., add on the peripherals, and it is still growing.

What I want to let you know is, it is about reliability. We do not need just reliable power, the way it was in 1960, we need not just 99.9 percent reliability, but 6 to 7 times the reliability, which is be-

tween 30 seconds of downtime per year and less than a second, because companies who rely on the Internet for their commerce can't afford to be cutoff by power that is lost. In terms of the impact, one expert reported a hit from \$75 to \$1 million a day. Companies that have called me on the phone are saying they were losing millions of dollars per hour. If it was the right building at the right time, it would be \$50 million per hour. So it has got a leveraged effect on the economy of Silicon Valley and, by extension, the country.

Chairman BLILEY. Could you summarize, Mr. Bradley?

Mr. BRADLEY. Yes.

So the solution we are seeking is threefold. We believe the responsibility of the user is to use energy more efficiently, and we need to remove market impediments to distribute generation so that the market, which is new, can take its place in the fast track investment in infrastructure, transmission and generation capacity.

Thank you very much.

[The prepared statement of Justin D. Bradley follows:]

PREPARED STATEMENT OF JUSTIN D. BRADLEY, DIRECTOR OF ENVIRONMENTAL AND ENERGY PROGRAMS, SILICON VALLEY MANUFACTURING GROUP

Mr. Chairman and members of the committee: Good morning, my name is Justin D. Bradley, Director of Environmental and Energy Programs for the Silicon Valley Manufacturing Group. I come from San Jose, California.

For many in Silicon Valley last week, computers were blank; offices were dark and fabrication plants were silent. The sound you did hear was high tech executives fuming at the unrecoverable losses to their companies, our economy, and nearly 100,000 residents who were directly impacted by the rolling blackouts of Bay Area customers. This was predicted. Only 100 hours prior to the June 14 record-breaking regional heat wave, several energy experts speaking at a Silicon Valley Energy Summit hosted by Oracle warned of interruptions this summer.

How could this happen? The Governor of California, Gray Davis wants to know too.

Davis issued a letter to the California Public Utilities Commission and Electricity Oversight Board last week to investigate circumstances that led to area blackouts, causing significant economic loss to Silicon Valley businesses. They have until August 1 to report and present a plan to fix the problems. However, that may be too late for the summer of 2000 and 2001.

We believe the California Independent Systems Operator, that ordered the rotating blackouts, has been doing a good job "reshuffling the deck" when demand peaks and power loads need to be redistributed. But when demand exceeds capacity of the system, it's like playing with a deck with only 49 cards. Somebody is dealt a losing hand.

The impact of these losses to Silicon Valley is difficult to measure. Information is competitive advantage and therefore closely guarded. Several Manufacturing Group companies did report significant losses measured both in dollars and time to market, and considered the situation unacceptable.

Additionally, a June 22 Reuters article reports that economists from the high-tech and energy sectors are projecting local companies can expect "a hit from \$75 million to \$100 million a day in Silicon Valley if there isn't enough electricity to keep industry on line." Even this estimate seems conservative since just one high tech company reported losses exceeding \$3 million in three hours when their manufacturing facility was blacked out.

These numbers illustrate the quiet vulnerability of high tech and the need for virtually uninterruptible power. The local power grid is able to reliably supply power 99.9% of the time, or about eight hours of downtime per year, which was fine for 1960. This is unacceptable for many given the steeper potential losses for companies at the forefront of the digital economy. They need "six to seven nines" (99.9999 to 99.999999%) of reliability, or between 30 seconds to less than 1 second down per year.

Silicon Valley Manufacturing Group companies are seeking a solution. As a first step we have formed an Energy Task Force comprised of both public and private sector representatives to remove the barriers and build the needed energy capacity.

Colorado understands the risk. They are contracting to build nine power plants to increase generating capacity by more than 25% by 2005, an Aunprecedented@ rate. Will Californians be as responsive to our energy infrastructure needs? That depends on how hot the weather gets this summer and it's ability to cool the NIMBY attitude that has effectively stopped needed generation and transmission infrastructure investment.

Chairman BLILEY. Mr. Brown.

#### **STATEMENT OF MARK H. BROWN**

Mr. MARK H. BROWN. Mr. Chairman and members of the committee, thank you for providing AAA the opportunity to testify today.

I oversee AAA's travel insurance, automotive and other lines of business. We have 88 affiliated clubs across the country with 1,100 branches, and we serve 43.5 million members in North America. We are the largest travel organization, and we think we are unique in that regard and we are in a unique position to monitor the gasoline price situation in the United States.

Mr. Chairman, Americans have always valued their freedom of mobility. Today, motorists are having freedom squeezed at the gas pump, and as they try to understand why these things are happening, they have asked us assistance in seeking answers. We operate a 24-hour check on the Internet on gas prices, and this morning they were \$1.64, 50 cents higher than a year ago today. As we heard this morning, \$1.64 would be well received in the Midwest. Literally, prices are out of whack in some of these regions. While there are no easy answers that we can provide our membership, we are faced with the difficulty in answering why, and there are several points we would like to convey to the committee.

The first is that despite these high prices and all of the frustrations at the pump, Americans are traveling in record numbers. We project that there will be 37.5 million travelers this Fourth of July weekend, 32 million will do it by car, and that is the biggest jump from last year to this year we have had since 1993. Clubs around the country were contacted for comments regarding travel. Members are traveling closer to home, and they are looking for travel opportunities within their State. They are opting to take more direct routes and less scenic routes. Members are evaluating the cost of airline transportation and redirecting vacation dollars to lower price hotels and meal options.

The vacation travel element is a fundamental of American life. Fuel prices at the current levels will not deter Americans from traveling. However, that is not to say that gasoline prices are not placing a real burden on working people who rely on their automobile to go to and from work, run errands or take their children to and from school and other activities central to life.

Cars are not a luxury; they are a necessity. Many people and families do not have the ability to simply forgo using a car, and that is why this issue hits home to Americans.

While vacation travel plans are being altered, gas price hikes are painfully regressive. They hurt lower- and fixed-income people more than others, and during the Persian Gulf War there was a clear link between pricing and price fluctuations. That link isn't quite as clear today as it was then as the earlier finger-pointing and accusations about the blame is being assigned, and yet we fail

to come up with the remedy. We are importing more oil than we ever have and the recent EPA Phase II RFG requirements are definitely having unintended consequences.

Speaking on behalf of AAA, I can assure the committee that pump politics will not ease the considerable angst that Americans motorists are going through right now. They want a serious discussion on how the situation will be avoided in the future.

Like any serious problem, we must address it at the root cause. What we do today must take into consideration the long-term consequences for gas prices and consumers. I think we ought to take the current situation as a wake-up call to adopt a more comprehensive national energy policy, one that includes the development of alternative fuels, increased domestic crude inventory and refining and better forecasting, so we don't get caught off guard regionally or nationally.

For our part, AAA recognizes it is equally important to educate consumers. AAA is making every effort to inform our motorists about the way in which they can conserve fuels and drive more efficiently. A smarter, more informed consumer reduces gas on the demand side, and we have the Gas Watchers Guide that we distribute extensively.

Mr. Chairman and committee members, I want to thank you for this opportunity to provide comment and I certainly look forward to any questions or issues you have. Thank you.

[The prepared statement of Mark H. Brown follows:]

PREPARED STATEMENT OF MARK H. BROWN, EXECUTIVE VICE PRESIDENT FOR  
ASSOCIATION AND CLUB SERVICES, AAA

INTRODUCTION

Thank you for providing AAA the opportunity to testify at today's hearing: "Summer Energy Concerns for the American Consumer." My name is Mark Brown. As the Executive Vice President for AAA's Association and Club Services, I oversee AAA's National Office travel operations.

With 85 affiliated clubs and more than 1,100 branch offices, AAA is one of the largest travel organizations in North America and is the largest provider of leisure travel in the country. Last year, AAA clubs generated \$3.4 billion in travel agency sales, primarily to AAA's 43 million members. Against this backdrop, AAA has been monitoring the gasoline price situation carefully since prices began their upward spiral earlier this year.

As a public service, AAA maintains a nationwide gasoline price report on the Internet, which is updated every 24 hours. At the beginning of this week, that report showed that the national average price for a gallon of regular unleaded gasoline was \$1.65. This compares to \$1.14 a year ago, or a 51-cent increase. In the volatile markets of the upper Midwest and Great Lakes where prices spiked to well over \$2.00 a gallon last week, we are beginning to see prices come down, but they remain "out of whack" with national prices, and continue to be a source of frustration to our members.

Once again, America's motorists are caught in a squeeze as they try to understand what is happening at the gas pump. They look to AAA, the largest motor club in the country, for answers. We have done our best to provide explanations without assigning blame or unnecessarily adding panic to the situation.

But, Mr. Chairman, it has been difficult. We have yet to see satisfactory answers to the current price situation. Unfortunately, efforts to find the truth have been dwarfed by finger pointing and accusations that seem geared less towards accounting for the dramatic fluctuations in price and more towards election politics. Discussion of this issue should be apolitical so that we can get to the root cause of the problem.

Despite the difficulty in answering the "WHY" part of the question, there are several points AAA wishes to convey to the committee.

## MOTORISTS ARE TRAVELING DESPITE IT ALL

Despite their frustrations, Americans are traveling in record numbers. AAA projects that, despite high gas prices, 37.5 million Americans will be traveling this July 4th holiday. Of those traveling, 32 million are expected to go by motor vehicle. This is nearly a 4% increase over the previous year and is the greatest one-year jump for this holiday since 1993. What this tells us, Mr. Chairman, is that travel is a fundamental fact of American life. Fuel prices in and of themselves will not deter Americans from their travel plans. America's booming economy coupled with high consumer confidence in the job market makes people feel more comfortable about spending time and money on a vacation.

In anticipation of my testimony, we invited each of our AAA Clubs around the country to share with us their observations about what they are seeing in members' travel requests and patterns. Certainly, they will be traveling in record numbers, but there are no discernible national or regional trends to indicate how or whether members are changing travel/vacation plans based on higher gas prices.

For example, let's look at the upper Midwest where gas prices soared to over \$2.00 per gallon. AAA Michigan reports that their members are planning trips closer to home; 41% of respondents to their club survey indicated that they will be traveling within the state; 35% of respondents said higher gas prices would impact their travel plans.

At the same time, in Chicago where gas prices are the highest in the country, our motor club has told us that they see no discernible difference in members travel plans or that members intend to travel shorter distances this year as a result of higher gas prices.

Our Western Clubs are seeing marginal to no effect on members' travel plans.

But, some of our clubs are seeing subtle shifts in members' travel plans. For example,

- Members are traveling closer to home and looking for more travel opportunities within their state;
- Members are opting to take more direct routes to their destinations, as opposed to scenic routes that might take longer and require more fuel;
- Members are evaluating the costs of air transportation versus traveling by car in determining their travel plans;
- There may be a redirecting of vacation dollars from higher priced hotels and restaurants to lower cost accommodations and fast-food chains to offset higher fuel costs.

While high gas prices may be aggravating to America's travelers, they are not enough to force postponement or cancellation of a long-sought vacation. Often planning for that family vacation occurs many months in advance of the actual trip. In addition to the anticipation and excitement of planning for the trip, reservations and deposits are made. Employers have been notified of employee leave plans. As long as there is assurance that fuel supply will remain uninterrupted, high prices will not deter Americans from traveling. That's because fuel prices represent a relatively small portion of leisure travel expenses. A family driving 1000 miles should be prepared to spend an additional \$25 over and above last year's fuel prices to make the trip. That's hardly enough to cancel that long-sought vacation.

## IT'S THE DAILY ROUTINE THAT HURTS

But, Mr. Chairman, there is no denying that high gasoline prices are placing a real burden on working people who must rely on their automobile to get to and from work, run errands, or take their children to and from school or the various recreation activities which are central to family life today. That's where the pinch is being felt. High gas prices impose a heavier burden on lower and fixed income people that we cannot ignore.

Mobility is a cardinal feature of American life. Americans value their freedom to choose where they live and work and how they commute between home and the office place. And, Americans are choosing to drive more than ever before. Since 1970, the U.S. population has grown by 30%, the number of licensed drivers by 61%, the number of vehicles by 90% and the number of miles driven each year by an amazing 130%.

Americans clearly treasure their mobility, and the mode of transportation of choice is their automobile. That's why the issue of gas prices hits home. That's why motorists are frustrated by unanticipated or unexplainable price hikes.

## MOTORISTS WANT ANSWERS

In the past, there has been a clear link between world or market events and resulting price spikes. Whether it was war in the Persian Gulf or suffering through another Arab embargo like we saw in the 1970s, motorists could clearly identify, and understand the reasons for price variations. Those links are less clear today.

Absent a clear, understandable "cause and effect" relationship, motorists are left to wonder who or what is interfering in the marketplace. Anxiety is further heightened when motorists in certain parts of the country see their gas prices skyrocketing beyond the national average, with no good explanation for why these price differentials exist.

On June 15 AAA called on the Environmental Protection Agency to issue a 90-day cooling-off period during which current requirements that reformulated fuels be offered as part of local clean air compliance programs would be waived. In addition to helping motorists during the heavily traveled summer months, the cooling-off period would give the EPA and the Department of Energy time to determine why some states, as opposed to others, are bearing a disproportional burden of price hikes.

AAA also supports the Federal Trade Commission's investigation of oil companies to determine whether price gouging may be occurring.

Speaking on behalf of AAA, I can assure you that "pump politics" will not ease the considerable angst of America's motorists. They want answers and better yet, serious discussion of how this situation can be avoided in the future.

## CONCLUSION

Mr. Chairman, we learned in the 1970s that reliance on foreign oil to meet a substantial portion of our energy requirements could wreak havoc on America's consumers and our economy. Those lessons are the same today. The fact that our economy remains strong has allowed Americans to live with an aggravating situation. Let's view it as a "wake-up" call to adopt a comprehensive national energy policy. That policy should include development of alternative fuels. And, while the purpose of today's hearing is to focus on the effects of this summer's energy concerns, remember that winter is not that far away. If not careful, decisions made by refiners today could negatively impact the home heating oil situation not too many months from now.

For our part, AAA is making every effort to help educate members and other motorists about the many ways in which motorists can conserve fuel and run more energy efficient cars. Our "Gas Watchers Guide" stresses to motorists that how you use your car can be just as important as which vehicle you use. A smarter, more informed consumer can help reduce the demand side of this equation.

Chairman BLILEY. Mr. Oxley.

Mr. OXLEY. I would like to introduce the next witness. Mr. Frank is a long time friend and my constituent in my hometown of Findlay, Ohio. He has been a leader in the oil industry for a number of years, and we are pleased to have him participate in the panel discussion today.

I yield back the balance of my time.

Chairman BLILEY. I hope, Mr. Frank, that he doesn't hustle you on the golf course.

## STATEMENT OF J. LOUIS FRANK

Mr. FRANK. I try to watch it when I am out on the golf course with him.

Thank you very much, Congressman Oxley. I am Louis Frank, President of Marathon Ashland Petroleum, and I welcome the opportunity to tell you our story today, because I think we have a good story to tell to explain the situation.

Let me start by saying that a very competitive gasoline market ultimately determines the price of gasoline. When there is a supply shortage in the competitive market, prices tend to rise to whatever level is necessary to balance demand with supply. When supplies return to normal levels, prices return to normal levels. Just such



an imbalance of supply and demand occurred in the Midwest over the past few weeks, and that is the reason that prices in the area surged.

First, worldwide crude oil prices have risen and been quite volatile. Second, refineries in the Midwest can supply only 75 percent of the region's demand. The balance, which is about 42 million gallons per day, must be transported into the region, and that would mean that a company twice my size, a new company, would have to be installed, to make it self-sufficient, that is dependent on the pipelines to get product to where it is required.

A very small amount is shipped by truck from neighboring States, but the vast majority of this product comes in from the Gulf Coast by barge up the Mississippi River or by two large pipeline systems; and if you look at the exhibit on the side—and there is one attached to my testimony—recent events illustrate the fragile nature of the refining products distribution system in the Midwest. A significant problem at a refinery or in the transportation system can create a shortfall of supply, and when this happens, the system has little or no capacity to play catch-up.

In March, one of these critical pipeline systems, the Explorer Pipeline, which you heard discussed extensively this morning, experienced a line failure followed by a 6-day outage, which resulted in a shortfall of 336 million gallons of product deliveries into the Midwest. That is approximately 8 million barrels.

Explorer was repaired and returned to system, but part of the system must operate at a reduced capacity pending completion of certain tests. As a result, the region continues to suffer a shortfall of up to 2 million gallons per day of pipeline deliveries into PADD II.

More recently, Wolverine pipeline, which carries about 40 percent of Michigan's petroleum needs from Chicago, also experienced a release and resulted in a 9-day interruption of supply in that area. That pipeline system has since returned to service. But as you heard this morning from the Secretary of the Department of Transportation, it is only shipping historic levels of gasoline into the Michigan market, whereas the State of Michigan was in dire straits for gasoline supply, and the city of Detroit and the surrounding counties require a 7.8 special gasoline mixture, and literally ran out of gasoline.

Another factor which contributed to the supply/demand imbalance was a new Phase II reformulated gasoline called RFG II, requirements which became effective on June 1 of this year. This gasoline is more difficult to make, there is no denying that, and the U.S. EPA regulation required us to drain our tanks of winter grade product before we accept deliveries of the low vapor pressure summer grade of gasoline in March and April at almost exactly the same time as the supply disruptions occurred with the Explorer pipeline.

As if these supply issues were not enough, EPA's decisions to grant three waivers from the RFG requirements for the St. Louis area, without any sort of penalty, became the straw that broke the camel's back in this supply scenario. Conventional gasoline that was originally destined for Chicago and the Milwaukee areas was immediately diverted to St. Louis. This contributed to a gasoline

shortage of conventional gasoline that was destined for Chicago that, in turn, led to the severe price increases for those products in Chicago.

What did my company do in response to the gasoline supply and demand imbalances in the Midwest? We continued to manage our supplies as prudently as we know how, and we took immediate and extraordinary steps to bring supplies into the Midwest. We ran our refineries and pipelines at full capacity, we utilized trucks and barges to bring product in from as far away as Newfoundland.

We have been asked by the U.S. EPA and the Department of Energy to comment on what could be done by the Federal Government to improve the Midwest supply situation in the short run. Our answer was submitted in writing on June 13 and is attached to my testimony. At the top of our recommendation is a suggestion that the United States Department of Transportation should take steps to get Explorer and Wolverine running at full capacity as soon as possible.

I would like to add that my company is working on longer-term infrastructure projects that could help ease situations like we have just experienced. For example, we are seeking rights-of-way and permits to construct a new refined petroleum products pipeline to serve the growing central Ohio market, but our progress has been hampered due to right-of-way litigation over what is the definition of petroleum for condemnation of right-of-way lands, and gasoline has not been judged to be—

Chairman BLILEY. Would you try to summarize?

Mr. FRANK. I would say that we have also joined with two other companies, a joint venture land pipeline from the Gulf Coast to the Midwest that would supply significant portions of gasoline right into the southern Illinois market and further into the Midwest.

In conclusion, I would say that I can't help but be outraged at the allegations that my company has had the burden of receiving: collusion and price gouging and price fixing, when our employees—and there are 28,000 of them—have been working around the clock, 7 days a week, to bring supplies into the Midwest and see where they are needed.

And that would conclude my statement, sir.

Chairman BLILEY. Well, I hope in your court case—when you have to define what “petroleum” is, I hope you don't have to define what “is” is.

Mr. FRANK. None have ever come to the conclusion that there has been that conspiracy that has been alluded to.

[The prepared statement of J. Louis Frank follows:]

PREPARED STATEMENT OF J. LOUIS FRANK, PRESIDENT, MARATHON ASHLAND PETROLEUM LLC

Good afternoon. I'm J. Louis Frank, President of Marathon Ashland Petroleum LLC, a company that makes and markets most of its products in the midwest.

I welcome this opportunity to discuss the gasoline market conditions we have just experienced in our part of the country and I look forward to answering any questions you or other members of the committee might have.

Let me start by saying that a very competitive gasoline market ultimately determines the price of gasoline. Worldwide, crude oil prices have risen rapidly and substantially. Refiners have experienced severe increases in the cost of raw material over a relatively short period of time. With this backdrop of rising crude costs, a

series of pipeline disruptions and other circumstances created a supply and demand imbalance in the midwest.

When there is a supply shortage in a competitive market, prices tend to rise to whatever level is necessary to balance demand with supply. When supplies return to more normal levels, prices tend to return to lower levels. This is a matter of simple economics in a market economy. Just such an imbalance of supply and demand occurred in the midwest over the past few weeks, and that is the reason that prices in the area surged. Let me explain.

Refineries in the midwest can supply only about 75% of the region's demand. The balance, about 1 million barrels (or 42 million gallons) per day, must be transported into the region. A very small amount is shipped in by truck from neighboring states, but the vast majority of this product comes in from the gulf coast by barge or by one of two large pipeline systems. (see attached exhibit titled "Regional Fuels Program.") Recent events in the midwest illustrate the fragile nature of refining and products distribution in the midwest. A significant problem at a refinery or in the transportation system can create a shortfall of supply, and when this happens the system has little or no capacity to play catch up.

In March, one of these critical pipeline systems, the explorer pipeline, experienced a line failure followed by a six-day outage, which resulted in a shortfall of about 8 million barrels (or 336 million gallons) of products to the midwest. Explorer was repaired and returned to service, but part of the system must operate at a reduced capacity pending completion of certain safety tests. As a result, the region continues to suffer a shortfall of up to 50 thousand barrels (or 2.1 million gallons) per day of pipeline deliveries.

More recently, wolverine pipeline, which carries about 34% of Michigan's petroleum needs from Chicago, also experienced a release that resulted in a nine-day interruption of supply to that area. That pipeline system has since returned to service, but it too is running at reduced capacity.

Another factor that contributed to this supply-demand imbalance in the midwest was the new Phase II Reformulated Gasoline (RFG) requirements which became effective June 1. Phase II RFG for the Chicago and Milwaukee markets is one of a number of unique fuels that Marathon Ashland Petroleum must make for different parts of the country. (See attached exhibit titled "Regional Fuels Program.") This gasoline is more difficult to make than the previous formulation. United States Environmental Protection Agency (EPA) regulations required us to virtually drain our tanks of winter grade product before we could accept deliveries of the low-vapor pressure summer grade of this gasoline in March and April. We had to begin building inventories of this new gasoline from ground zero at almost exactly the time as the supply disruptions with explorer were unfolding. In addition, concerns with Unocal's gasoline patents may have constrained production of Phase II RFG.

If these supply issues were not enough, EPA's decision to grant three waivers from the RFG requirements for the St. Louis area without any sort of penalty became the straw that broke the camel's back. In a letter dated May 18, 2000, describing one of these waivers, the EPA acknowledged the shortage of RFG in the St. Louis area, citing the explorer outage, and encouraged marketers in that area to build up their inventories of RFG while distributing conventional gasoline in the market. The result was predictable.

Conventional gasoline that was originally destined for the Chicago and Milwaukee areas was immediately diverted to St. Louis. This contributed to conventional gasoline shortages that in turn led to severe price increases for those products in the Chicago and Milwaukee markets. These shortages and price increases eventually spread to other parts of the midwest. (see attached exhibit titled "Chicago Market Wholesale Gasoline Prices.")

What did my company do in response to the gasoline supply and demand imbalances in the midwest?

We continued to manage our existing gasoline supplies as prudently as we knew how, and we took immediate and extraordinary steps to bring additional supplies into the midwest. In fact, we have supplied about 10% more gasoline to the midwest this year than last year. To do this we ran our refineries at full capacity, and, because pipelines were not available, we utilized higher cost trucking and barges to bring product in from other areas. We contracted to ship gasoline in from as far away as Newfoundland, Canada.

What could be done to improve the midwest supply situation in the short run?

While midwest inventories are slowly building and prices appear to be dropping, the supply situation is still quite tenuous. Any further pipeline or refinery problems could cause the supply shortage to recur. At their request, Marathon Ashland Petroleum submitted to the EPA and United States Department of Energy (DOE) a list

of measures that government could take to provide some short-term relief to the midwest.

At the top of this list is the recommendation that the United States Department of Transportation (DOT) take whatever steps are necessary to get explorer and wolverine safely running at full capacity as soon as possible. We also recommend that DOT grant relief on driver hour restrictions for transport drivers in the midwest and that the larger trucks used in Michigan be allowed in other midwest states. Temporary removal of terminal vapor recovery units limits and tank operating restrictions will be of help in certain locations. A complete list can be found in the attached copy of Marathon Ashland Petroleum's letter to EPA and DOE.

My company is currently working on several longer-term infrastructure projects that could help ease situations like the one we just experienced. We're seeking rights of way and permits to construct a new refined petroleum products pipeline to serve the growing central Ohio market, but our progress has been hampered due to right-of-way litigation. We've also joined two other companies to convert a natural gas pipeline into a new products pipeline from the Gulf Coast to the midwest, including the Chicago area. Federal and state governments could help by expediting the permitting process for these significant projects as well as others our company has planned, and by rethinking the demands on petroleum refining and marketing posed by new fuels regulations.

It is often mentioned that the United States does not have a cohesive national energy policy—one that would recognize the importance of ample, affordable and clean energy for the nation. Such a plan would encourage a viable and vital domestic petroleum industry—both upstream and downstream. It would also emphasize the need to increase the energy independence of the United States. Ideally it would then provide our citizens sufficient energy at a cost that will sustain our economic growth in an environmentally responsible manner.

Significant components of a comprehensive national energy policy would include the following features:

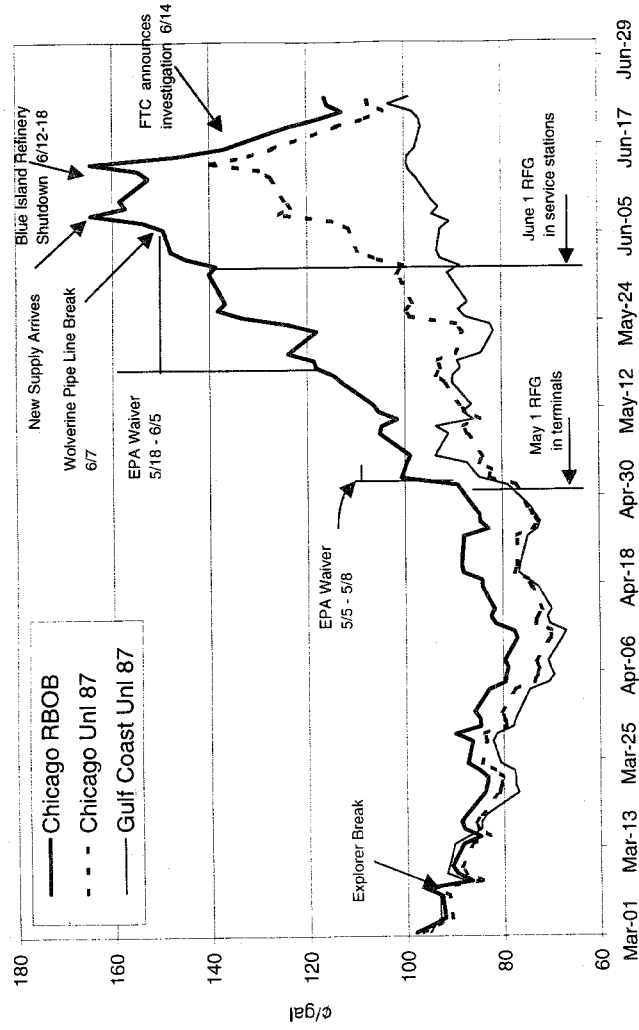
- encourage increased crude oil production from marginal wells—those that produce less than 10 barrels per day.
- open federal lands for environmentally responsible exploratory drilling for crude oil.
- open offshore areas for drilling in deep waters.
- recognize the need for strengthening the downstream infrastructure of the domestic petroleum industry—the sector that includes refining, pipelining, terminaling and marketing.

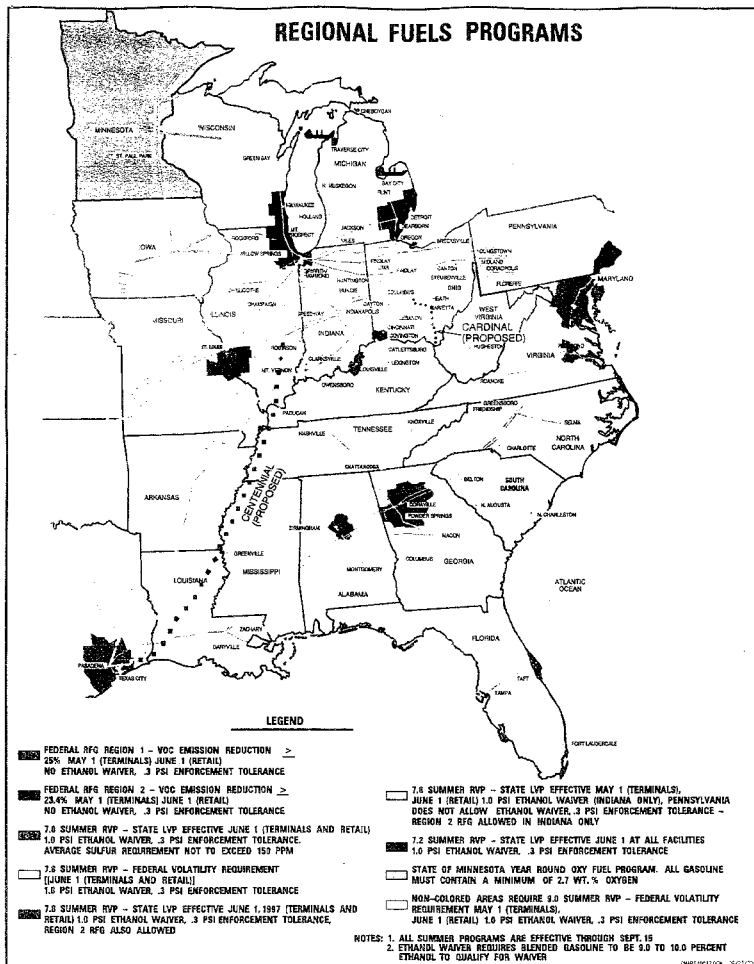
In closing, let me say that I am very proud of the way Marathon Ashland Petroleum responded to this situation and, on behalf of the 28,000 employees of my company, I am sincerely and profoundly offended by any allegation or insinuation that we have engaged in either price gouging or collusion with our competitors.

And I am equally offended by assertions that prices have come down in response to calls for an FTC investigation. As I said in my opening remarks, the gasoline market is highly competitive and the market ultimately determines the price of gasoline. Prices in the midwest went up in response to a supply/demand imbalance and they have responded as additional supplies became available in the market. It is a matter of simple economics. However, the system is fragile and any significant disruption in a refinery or in the distribution system could result in another supply-demand imbalance in the midwest.

Again, I appreciate this opportunity to appear before this committee, and I look forward to answering any questions you or other members of the committee may have.

## Chicago Market Wholesale Gasoline Prices





J.L. Frank  
President



**MARATHON ASHLAND** Petroleum LLC

539 South Main Street  
Findlay, OH 45840-3295  
Telephone 419/422-2121

June 13, 2000

VIA FAX: 202/564-1686

VIA FAX: 202/586-0148

Robert Perciasepe  
Assistant Administrator  
Office of Air and Radiation  
Environmental Protection Agency

Melanie Kenderdine  
Acting Director  
Office of Policy  
Department of Energy

Dear Ms. Kenderdine and Mr. Perciasepe:

Subject: Recommendations for Actions for Shorter-Term Relief of Midwest  
RFG-Conventional Gasoline Price Spread

In our meeting on Monday, June 12, you requested our recommendations for actions the federal government might take to relieve the current price differential between RFG and conventional gasolines in the Chicago and Milwaukee areas. We don't like these sorts of situations either. They are not good for us or our customers. Recent evidence seems to indicate that the price differentials between RFG and conventional gasolines is beginning to narrow in these areas. For example, the differential between RFG and conventional in the Chicago spot market has narrowed by a total of thirteen cents since June 9<sup>th</sup>, including an additional seven cents today.

We have already explained that Marathon Ashland is selling approximately 20% more product in these areas than last year, and that there is no "magic bullet" that will bring instant relief. We have also explained that a waiver of the RFG requirement would not solve the problem and that such a waiver without an appropriate penalty and enforcement mechanism could actually make the situation in the Midwest worse. Such a waiver would only serve to further undermine the credibility of the clean fuels program and add to the atmosphere of uncertainty that industry already faces with respect to clean fuels investments.

While we do not believe a waiver is needed, if you do grant a waiver, the most effective way to do so would be to grant a temporary waiver, with an appropriate penalty and enforcement mechanism, for the sale of Tier I RFG in Milwaukee and Chicago in lieu of Tier II RFG.

Robert Perciasepe  
 Melanie Kenderdine  
 Page 2  
 June 13, 2000

There are some things that the federal government could do, many of them in partnership with industry or state government, to improve the current situation in the shorter term. The actions that we recommend, giving paramount consideration to safety concerns, are as follows:

1. Expedite an increase in Explorer Pipeline operating pressure. Explorer Pipeline is currently at reduced pressure under DOT order.
2. Grant relief on DOT driver-hour restrictions for transport truck drivers operating in Ohio, Indiana, Illinois, Wisconsin and Michigan.
3. Grant relief in Ohio and Indiana to use the larger and heavier trucks currently utilized in Michigan.
4. Expedite the restart of Wolverine Pipeline and its return to full operating pressure.
5. Grant relief on restrictions of foreign flag vessels to deliver product to the U.S. on the Great Lakes.
6. Attempt to arrange some short-term relief on patent license fees with Unocal to take some of the uncertainty out of the RFG market.
7. Allow temporary exceedances without penalties at terminal vapor recovery units that are at or near capacity because of heavy throughput volumes due to market dislocations.
8. Grant terminal operators flexibility to operate tanks with floating roofs below normal operating minimums so greater tank volumes than are currently available can be distributed within the market.
9. Consider utilization of military transport trucks and other assets to provide additional transportation of motor fuels within the affected areas.

None of these actions individually is likely to create a rapid price response, but collectively they will add to the industry's ability to get product to the market and move product where it is needed within the market.

Although your current focus is on shorter-term solutions, we must take this opportunity to restate our concern that the situation you see now in the Chicago and Milwaukee markets will be repeated next year and will spread to other parts of the country:



Robert Perciasepe  
 Melanie Kenderdine  
 Page 3  
 June 13, 2000

1. A phase down of MTBE use with an oxygenate or renewable fuels mandate will cause similar problems in other RFG markets. We urge that your agencies support elimination of the oxygenate mandate and that you not support a renewable fuels mandate that would restrain our ability to provide adequate product supplies and distribute them efficiently.
2. The low sulfur diesel regulations now under consideration will strain the U.S. refining and logistics system to the breaking point. This could cause nationwide price and supply problems for on-road diesel. A phase-in of low-sulfur diesel would make this situation even worse. We urge you to reconsider the extremely low sulfur requirements that the proposed regulations would mandate.
3. Marathon Ashland is directly or indirectly involved in three major pipeline projects that could significantly increase the industry's ability to move products into the Midwest. Government action to expedite these projects could prevent a repeat of this year's supply difficulties:
  - a. Wolverine Pipeline is currently in the process of obtaining rights of way and permits for a 16" pipeline from Jackson, Michigan, to Stockbridge, Michigan, and a 12" line from Stockbridge to La Paugh, Michigan. Government could expedite the permitting process for this project, including related tank construction.
  - b. Centennial Pipeline, of which Marathon Ashland is a one-third owner, is currently trying to obtain FERC abandonment of a CMS Energy 26" pipeline from natural gas service. This pipeline will be converted from natural gas to products service from the Gulf Coast to the Midwest, including the Chicago market. The government could expedite this process. The government could also expedite the environmental assessment and permitting processes for this very significant project. An Environmental Assessment was submitted in 1999 and the governmental review process was nearly completed, but the assessment was withdrawn so CMS could enter into a joint venture to develop the products pipeline. Expediting the review process could accelerate this project by six months or more.
  - c. Marathon Ashland is in the process of obtaining rights of way and construction and environmental permits for a new products pipeline from its Catlettsburg, Kentucky, Refinery to Columbus, Ohio, serving the Central Ohio market. Government could expedite this permitting process.

Robert Perciasepe  
Melanie Kenderdine  
Page 4  
June 13, 2000

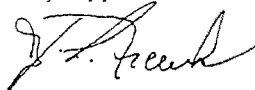
4. Government should take action to prevent private companies from obtaining patents on fuel blends that are mandated by fuels regulations. License fees on such patents amount to private "excise taxes" that only add to the price of cleaner fuels and further restrict market efficiency

Finally, we take serious issue with the statements by government officials at the highest levels that we are engaged in either price gouging or collusion with our competitors or customers. We want to go on record as stating that we absolutely and unequivocally deny that we have engaged or are engaging in either price-gouging or collusion. We do not fear the outcome of an investigation into our behavior, but we think that such an investigation would not be a productive use of resources. We are producing and shipping to the Chicago and Milwaukee areas as much RFG and reformulated gasoline as we can. We are taking extraordinary actions to supply our regular customers as well as the rest of the market.

Governmental accusations of price gouging or collusion only inflame what is already a volatile situation and, in fact, put more pressure on government to take action "against" the refiners and others that are supplying this market. This sort of rhetoric is totally counterproductive.

We would be happy to provide you with more details on any of the recommendations mentioned above. We would also be happy to meet with you or other governmental officials at any time to give you our viewpoint on this highly dynamic situation.

Very truly yours,



JLF/ab

cc: (Via Fax and Overnight Mail)

The Honorable Carol M. Browner  
Administrator  
Environmental Protection Agency  
1200 Pennsylvania Avenue, NW/1101A  
Washington, DC 20460

FAX: 202/501-1450

The Honorable Bill Richardson  
Secretary of Energy  
U.S. Department of Energy  
1000 Independence Avenue, SW  
Washington, DC 20585

FAX: 202/586-4403

Chairman BLILEY. Mr. Gale.

**STATEMENT OF ROGER W. GALE**

Mr. GALE. Thank you very much, Mr. Chairman. I appreciate the chance to talk to you about the electric system of the United States and its reliability as part of your investigations today.

Our firm has 300 energy consultants in 15 offices around the world, and we work for the largest utilities in the world, as well as many of the smaller municipals and co-ops. Our sense is, for the most part, the utility industry in North America has done an excellent job of providing the reliability that has been necessary to this point, but unless there is a major rebuilding of that system, the distribution system and major expansion of the transmission system, we will begin to see a fairly rapid deterioration in quality in the years ahead.

Right now, we see that the incentives to do that rebuilding of transmission and distribution are simply not there, particularly on the transmission side, and it is critical that the industry be given those incentives through the State regulatory process and through activity by Congress. When we look at the generation sector, data we have shows that there are about 207,000 megawatts of new generation planned in the United States, about 44,000 megawatts of new generation actually under construction. There are problems, as anybody in the generation business will tell you, in getting plants sited and built, but that part of the industry is doing well, the price signals, the opening of the market that FERC has managed over the years has put that part of the industry in a relatively good position to do its job well and to go out and build.

There has been a lag in construction, so we do have some delays and we do have shortages in some regions, but that part of the situation is being fixed. The problem we face is primarily a delivery problem of the transmission system that is balkanized, sets poor pricing signals and has congestion that is advantageous for some of the owners to maintain rather than what you would have in a more competitive industry, incentives to get rid of that congestion by growing and increasing the markets.

We don't see any one step where there is an instant solution to this problem, but we very much support the activities of this committee and the Chair to take a look at these issues. Reliability can best be addressed, we think, by focusing on the things that are in most need of attention, and that is the transmission system. We need to put in place a competitive, move-energy-for-profit system. It will be in the interest of all Americans to do that.

Congress has got to take the lead and make the effort to do that. This is a project that is no less important and no less ambitious and probably, over the next 20 years, no less costly than building the interstate highway system and building all of the fiber optics and all of the additions that we are putting into our telecommunications facilities. Unlike the interstate highway system, this can be done without government money, and it can be done on a purely for-profit basis if the rules are right and Congress establishes a set of parameters that make sense. It is critical in our mind to see this happen quickly.

What we see as important is that Congress quickly address the issue of siting to build new lines. In the 1930's, Congress gave the natural gas industry a siting regime that allows for Federal siting of transmission. It is time to work on that issue for Federal electric regulation for siting.

I know that is a sensitive and difficult issue. It raises tremendous issues about Federal and State authorities, but without greater ability to site and to deal with things on a comprehensive, multistate, regional, long distance delivery basis, we will not be able to solve in a comprehensive way some of the issues.

We have to provide incentives to upgrade the current system. Today, in the Northeast, we can increase the amount of electricity going through the existing transmission lines by 20-25 percent without stringing a new wire. In some of the western States, it is probably 40 to 50 percent increases in the amount of electricity going through existing wires if we allowed and had incentives for people to invest money in upgrading the switching and delivery system.

On top of that, we are estimating a 3.7 percent increase in construction in the total volume and length of the transmission system in the next 8 years, almost nothing. It takes 25 years to add transmission in this country because of the difficulty in siting. We need a for-profit incentive to run the system as efficiently as possible.

We realize that there is a great debate about the value of a for-profit transmission system, as opposed to an RTO structure that is incentivized without being privately owned or for profit. There a great deal of reasoned debate on both sides of this issue, but unless the profit incentive is there and there is an incentive to buy and price and put transmission assets together into larger entities, we are not going to get the economies of scale and the management depth that we need.

It is also an issue that has gotten an awful lot of environmental attention over the years. We have not seen as much of that over the years, but the siting effort is one that has to be dealt with.

And finally, there have to be adequate rates of return. The industry will tell you it is not high enough and it never will be high enough, but today there is much less certainty about what it ought to be, and it needs to be the range of a gas pipeline, and they are happy to tell you that their rates are not as high as they should be. It is not so much the rate as it is the predictability and the ability to know that one can plan and build around a rate of return.

A final point that I think is important to emphasize, and it has not been dealt with yet by Congress, nor much by the States, and it is a point that was raised in the first presentation by Mr. Bradley, looking at Silicon Valley. PG&E, I remember being quoted as saying that they recognize that they have a 1930's-vintage distribution system in Silicon Valley and that is the distribution system that we do run in this country. It is reliable, and it has been maintained well, although expenditures have gone down in the last 10 years; but that system needs upgrading. And Congress at this point, Mr. Chairman, I don't think, is ready to take over control of the distribution system from the States, but Congress could certainly use its powers to encourage the States to provide additional incentives, to provide higher rates of return and recognize, as mar-

kets have opened and utilities have been put in the position of having price caps and price freezes, they are in a difficult position to be able to upgrade system until those caps and those freezes expire.

This is a very excellent system, but it is one that Congress needs to work on and move quickly to try to encourage incentives to rebuild. Thank you.

[The prepared statement of Roger W. Gale follows:]

PREPARED STATEMENT OF ROGER W. GALE, PRESIDENT AND CEO, PHB HAGLER  
BAILLY

As Americans become more dependent on e-commerce and e-information in their daily lives, the quality and reliability of electricity supply also becomes more important. America's electric utilities—investor-owned, public, cooperatives and federal—have generally done an excellent job of providing reliable service. But a massive rebuilding of the electric delivery system over the next two decades is needed to maintain quality service in the new e-century. We are already beginning to see deterioration in reliability in some parts of the country.

This summer and for ensuing summers we will continue to muddle through but it is time for Congress and the states need to work together to build a new regulatory compact for the new century. In addition to competition issues, Federal legislation needs to deal with reliability head-on and needs to be passed as soon as possible to create a consistent national framework for success. There is no instant, "one-step-we're-there" solution but an aggressive first step on reliability is needed now. By raising the reliability issue, Congress has already had a constructive impact focusing attention on our national vulnerability.

This summer, as in previous summers, some consumers may be affected by power failures as the industry learns how to cope with competition. Competition will eventually lead to improved reliability but we are now going through a period of trial-and-error in getting the rules of competition right. Congress can assist by creating a consistent set of transparent wholesale pricing and access rules. Especially in transmission, there will be few incentives to upgrade and expand the system until Congress creates a single set of transmission rules and encourages as much of a national market as is technically possible, with siting rules, independent management and control, higher rates of return and investment incentives. A competitive move-energy for-profit transmission system is in the interest of all Americans.

The electric generating industry is doing an excellent job of catching-up following a fallow period in which little new generation was built. According to PHB Hagler Bailly's database, more than 207,000 megawatts of new capacity is planned with more than 44,000 megawatts actually under construction. Temporary shortages of electricity generating capacity in the Midwest and other regions are being quickly resolved with the installation of new units including peaking plants. The dramatic and now sustained improvement of nuclear plant performance is also an important contributor to supply in some regions. Having successfully weaned itself of its dependence on oil to generate electricity, few of America's electric power companies are part of today's oil price problem.

Delivering electricity to the customer is emerging as the real long-term problem. Congested transmission lines, bad pricing signals, and balkanized control all contribute to the problems we now face. The Federal Energy Regulatory Commission has done its share to focus attention on these issues and has pushed the limits of its regulatory authority and needs additional authority from Congress to get the rules right. Not everyone wants FERC to have more authority but without a stronger federal role, the market will continue to be a collection of fiefdoms, instead of the vibrant growth-oriented business sector that this country needs right now. Based on industry statistics, current plans call for adding only 3.7% to the total capacity of the existing transmission system over the next 8 years. And with no incentive to upgrade existing lines with electronic switching and other improvements, America faces a potential transmission crisis in the years ahead.

In addition, America's electric distribution system that brings power from the transmission grid to our homes will require a massive rebuild in the next 20 years. While the transmission system needs to be expanded, the distribution system requires major overhaul. Most utilities operate their systems reliably but the systems lack automated controls and other backups, and with the growth of distributed generation, major changes will be needed. Few utilities are able to make these investments because rates of return are not high enough and because in many states

there are rate freezes in place as part of the settlements that are opening markets to customer choice. Blackouts in major cities in last few years highlight the need for a massive investment. Competition will keep consumer prices down although, as we are witnessing in telecommunications but not in electricity, the right price incentives will also encourage system investment and upgrades as new players enter the market and compete with the incumbents.

In short, the existing utility infrastructure has served us well but we are already overdue in starting the rebuild we need. Congressional leadership is critical to creating the national incentives to get this job done. This job is as big and as important as was the construction of the interstate highway system and the huge investment that is now taking place in fiber optics and other communications links. It can be accomplished without any government subsidies—but only if Congress passes comprehensive electric industry legislation that creates the right financial incentives for utilities and new players to move forward—now.

Turning to specifics, what is needed?

The most important congressional action is to create a new independent transmission industry with siting authority to build new lines, incentives to upgrade existing systems, for-profit incentive to run the system as efficiently as possible, strong attention to environmental concerns, and adequate rates of return that exceed today's limits.

Transmission is the weak link in the system. Companies that own generation should not be allowed to control transmission. FERC is paving the way for these changes but Congress needs to step in immediately to create a comprehensive, transparent set of wholesale transmission pricing and siting rules. Congress may not yet be ready to tackle federal siting for electric transmission but it needs to realize that it established federal siting rules for gas pipelines more than 65 years ago. Siting of electric transmission like gas transmission and telecommunications should be a federal responsibility.

Congress needs to provide its blessing to the development of Regional Transmission Organizations and send a strong signal that we need to move quickly toward creation of a North American transmission system, that includes Canada and Mexico, built around large regional organizations that are incentivized to encourage new construction and eliminate congestion. There is legitimate debate about the number of RTOs we'll eventually need but while recognizing the need for regional diversity, the rules have to be similar enough to create a seamless market.

Congress needs to signal the industry that it encourages self-regulation of reliability through the new North American Electric Reliability Organization (NAERO). Federal legislation is needed to enable NAERO to take on this responsibility.

Congress needs to encourage the states to provide new incentives to distribution owners to upgrade their networks. If the states don't respond, Congress should work with FERC and the Department of Energy to establish rigorous distribution system performance standards and to encourage states to allow utilities to invest more in upgrading local distribution systems. Innovative performance-based rates can provide the push needed to get capital flowing. Without a significant increase in investment, adequacy of service will decline just at the time that more and more Americans are becoming dependent on the Internet as part of their daily lives for everything from paying bills and shopping to doing homework. Price freezes that have been imposed to protect the consumer need to be reexamined in light of the need to invest more now in preventing the deterioration of service. Distribution remains a state-level responsibility but Congress needs to take the initiative to fix this growing nationwide problem.

Congress needs to work with the Department of Energy and others to quickly commercialize e-based energy management technologies that can dramatically improve energy efficiency and environmental compliance. Automated meter reading, wired appliances and the ability for consumers to remotely control their energy demand through the Internet is one of the most promising ways to reduce overall demand. Combined with distributed generation, these market-based technologies have the potential for being the single biggest improvement in energy use and environmental stewardship.

None of these reforms can be implemented *this* summer, but speedy, decisive action now to provide the electric power industry with market-based incentives, will mean we won't have to worry about this *every* summer.

Thank you.

Chairman BLILEY. Thank you.  
Mr. Gerken.

**STATEMENT OF MARC S. GERKEN**

Mr. GERKEN. Thank you, Mr. Chairman and members of the committee. For more than 15 years, AMP-Ohio has been involved in the competitive purchase and delivery of wholesale power as an aggregator for its members, who total 83. Ohio's electric systems gained access to transmission wheeling and the ability to shop electricity generation services long before the Energy Policy Act of 1992 that requires wheeling of wholesale power.

As an active participant in the wholesale power market, AMP-Ohio has experienced the benefits of competition as well as the threats of system reliability and price spikes of the past few years. While maintenance of system reliability is a traditional purview of engineers and utility operators, the system is showing signs of emerging crisis and Congress must move.

Public power systems nationally support the consensus of NERC and narrow legislation that creates an enforceable system of mandatory reliability standards. Unfortunately, enacting this legislation alone will not ensure system reliability nor will it tackle the underlying problems.

Our organization sits on every one of those boards, and you must remember that they are usually maintained by merchant people. While there are constrained transmission interfaces, a lot due to the fact that we are moving power from East to West and from West to East, we also need generation addition and transmission improvements. In our opinion, the root cause of these problems is market manipulation and market structure. If Congress is serious about promoting system reliability, we encourage you to break the hammerlock that encumbered utilities have over transmission systems.

With the transmission system owned and operated by vertically integrated utilities, there is an inherent incentive to manipulate the transmission system to the advantage of a utility's own generation and sales. In recent years, at AMP-Ohio, we have been told months in advance that there are no, or zero, transfer capabilities for an entire month to move one single kilowatt hour of power.

In past years we have not been asked to run generations that could reduce transmission constraints, with the host utility seemingly preferring to keep the constraint in place. On one occasion last year a major company sent well over 2,000 employees home in the middle of the day because of voltage restrictions. Also, in recent years we have been told that we could not move power in either direction on a transmission line, something that my understanding the laws of physics suggests is completely impossible.

The bottom line is that the current arrangement doesn't work. In our viewpoint, it is like permitting a trucking company to own the interstate highway system and having that trucking company provide its own trucks preferential access and multiple lanes while shunting competitors to a clogged toll road.

We believe that Congress can fix these problems. To that end, we encourage Federal lawmakers to: affirm FERC's authority to promote formation of regional transmission organizations, RTOs, that are truly independent, geographically broad and operationally robust; Facilitate the interconnection of generation and load to the transmission grid. In the last year, we have had a host of privately

owned companies willing to cite generation peak savings because it is a lot easier. They don't have 3 years to do it.

Provide FERC appropriate jurisdiction over all uses of the transmission system and also authorize FERC to be the "cop on the beat" to remedy situations where generation markets power undermines the competition.

I commend Chairman Bliley for spotlighting a lot of these issues.

I understand that private utilities believe today's transmission constraints will be relieved if only FERC approved higher rates of return or other incentives. Let me offer my following observations to this:

Failing to relieve the transmission constraint allows the utility to charge substantial premiums on power sales from generation plants that represent the majority of the utility investment. Transmission is a modest share of the utility plant investment. Bumping up the rate of return by a few basis points would have a minimal impact on utilities' bottom line. Simple math suggests that the lack of incentives is not the principal impediment to relieving transmission constraints; rather, these constraints further utilities' profits.

Transmission siting is and will remain a significant problem, especially when we are building a line in one State that is going to benefit another State in a greater capacity. We believe that giving the independent RTOs planning authority for expanding transmission service for the entirely regional market is the solution.

Transmission remains a monopoly function. As such, it should receive a regulated rate of return, the existence of which for many years did not seem to impede investment in utilities. Instead, returns are simply excessive profits.

I read with interest a recent news report about an internal FERC memo, and the memo noted that while transmission owners post volumes of data on the Open Access-Same Time Information System, which is called OASIS and is a scheduling software, it is nearly impossible for anyone to use OASIS to obtain pertinent data for overseeing transmission market behavior and assessing how well the markets are working. I would suspect that this may cause you pause. We hope this bolsters the call for reform as outlined above.

I can tell you that in 1999 we had an instance where this occurred. We went to FERC, we showed them the OASIS data and it didn't prove anything in their eyes. We feel that it has to be bolstered even better.

AMP-Ohio stands ready to work with the committee to provide legislation that provides both system reliability and effective competition in the electric utility industry. Thank you very much.

[The prepared statement of Mark S. Gerken follows:]

PREPARED STATEMENT OF MARC S. GERKEN, ON BEHALF OF AMERICAN MUNICIPAL POWER-OHIO, OHIO MUNICIPAL ELECTRIC ASSOCIATION, TRANSMISSION ACCESS POLICY STUDY GROUP, AND AMERICAN PUBLIC POWER ASSOCIATION

#### *Introduction*

Good morning, Mr. Chairman and members of the committee, I am Marc Gerken, President of American Municipal Power-Ohio in Columbus, Ohio.



I am pleased to appear before you today representing the concerns of AMP-Ohio, the Ohio Municipal Electric Association (OMEA), the Transmission Access Policy Study Group (TAPS) and the American Public Power Association (APPA).

AMP-Ohio is a nonprofit wholesale power supplier and services provider for municipal electric utility systems, including 78 of Ohio's 85 community-owned electric utilities, three in Pennsylvania and two in West Virginia. Ohio municipal electric systems account for approximately six percent of the electric sales in Ohio, serving about 350,000 meters statewide. Our organization has 183 employees between our headquarters and power plant operations, and total operating revenues of more than \$223 million. Our members receive their power supply from a diversified resource mix, including: wholesale power purchases through AMP-Ohio and on the open market; energy produced at the 213-megawatt, coal-fired Richard H. Gorsuch Generating Station operated by AMP-Ohio; individual community-owned generation facilities; and municipal generation joint ventures such as the 42-megawatt, run-of-the-river Belleville Hydroelectric Project. Ohio's municipal electric systems do not own significant transmission facilities, and therefore are transmission dependent. In 1999, the non-coincidental peak for AMP-Ohio member communities was 1,958 megawatts. Our energy control center has handled arrangements to move power across as many as 18 different transmission systems in one year.

For more than 20 years, AMP-Ohio has been involved in the competitive purchase and delivery of wholesale power as an aggregator for its members. Through interventions in regulatory proceedings involving Ohio investor-owned electric companies, Ohio municipal electric systems gained access to transmission wheeling and the ability to shop for electricity generation services long before the federal Energy Policy Act of 1992 required the wheeling of wholesale power. As a result, Ohio has experienced the benefits of a competitive wholesale market for many years, and Ohio municipal electric systems played a key role in this arena. By the same token, our experience in the competitive market has provided us with first-hand examples of the presence and abuse of market power and underscores our position that market power must be addressed legislatively for consumers to receive reliable service and for wholesale and retail competition to be a success.

The OMEA is the state and federal legislative liaison for Ohio's municipal electric communities. TAPS, a coalition of transmission dependent utilities in more than 29 states, advocates open, non-discriminatory transmission access. APPA is the national service organization representing the interests of more than 2,000 municipal and other state and local government-owned utilities throughout the U.S. While APPA member utilities include state public power agencies, and serve many of the nation's largest cities, the majority of APPA members are located in small and medium-sized communities in every state except Hawaii. APPA members produce about 12 percent of the nation's energy and serve about 15 percent of all kilowatt-hour sales to ultimate consumers in the U.S.

#### *Our recent experiences in the wholesale market*

As an active participant in the Midwest wholesale power market, AMP-Ohio has experienced the threats to system reliability and price spikes of the past few years. While there are constrained transmission interfaces and a need for generation and transmission additions—in our opinion, the root cause of these problems are market manipulation and market structure.

If Congress is serious about promoting system reliability, we encourage you to break the hammerlock that incumbent utilities have over the transmission system. With the transmission system owned and operated by vertically integrated utilities, there is an inherent incentive to manipulate the transmission system to advantage a utility's own generation and sales. In recent years, we have:

- Been told months in advance that there would be zero transfer capability for an entire month and that we would be unable to move a single kilowatt-hour of energy;
- Not been asked to run generation that could reduce a transmission constraint, with the host utility seemingly preferring to keep the constraint in place; and
- Been told that we could not move power in either direction on a transmission line—something that my understanding of the laws of physics suggests is impossible.

I'll offer a few specifics on the third event, which clearly resonates in my memory since I was working closely with our energy control center at the time it occurred. At 2 p.m. on July 30, 1999, AMP-Ohio had 20 megawatts of load available from a member generator in one Ohio utility control area. We attempted to transmit that 20 megawatts to serve member load that had experienced an interruption of a power resource in a different utility control area. Our request for transmission was denied due to a claimed lack of available transmission capacity (ATC). Interestingly

enough, a check of the ATC across the interconnection in the opposite direction showed no capacity in that direction either. We were amazed that an interface could be fully loaded in both directions at the same time—one would think that some unloading would occur, even be encouraged, as opposing reservations or uses are made. Given this physical fact, we had to question whether the assertion about ATC was accurate. The end to this story is that the replacement power for the interrupted resource was provided at a cost of \$4,000 per megawatt hour by the control area utility—about 40 times the cost of generating our own power.

The bottom line is that the current arrangement does not work. In our viewpoint, it is like permitting a trucking company to own the interstate highway system—and having that trucking company provide its own trucks with preferential access and multiple lanes, while shunting competitors to a clogged toll road.

#### *Need for comprehensive federal legislation*

We believe that Congress can and must fix these problems. To that end, we encourage federal lawmakers to enact comprehensive legislation that will:

- Affirm FERC's authority to promote formation of and require participation in regional transmission organizations (RTOs) that are truly independent, geographically broad and operationally robust;
- Facilitate the interconnection of generation and load to the transmission grid;
- Provide FERC appropriate jurisdiction over all uses of the transmission system; and
- Authorize FERC to be the “cop on the beat” to identify and remedy situations when generation market power undermines competition.

While maintenance of system reliability is the traditional purview of engineers and utility operators, the system is showing signs of an emerging crisis that Congress must address.

Public power systems nationally support the consensus NERC/NAERO legislation that creates an enforceable system of mandatory reliability standards. Unfortunately, enacting this legislation alone will not ensure system reliability, nor will it tackle the underlying problems.

For example, as the Committee knows, last summer a Midwest utility “leaned” on the transmission system and drew into its system 1,800 MW of power that it did not own. The utility apparently did this in order to avoid paying the high market prices at the time. With adoption of the NERC reliability language, that utility would be required to pay the cost of then-prevailing power—rather than repaying the system later when prices are lower. However, the reliability-only legislation does not remove the underlying incentives that caused the problem.

Only the placing of control of the interstate transmission grid in independent hands can fix this problem. We strongly support affirming FERC authority to promote RTOs. At a minimum, Congress must affirm the underpinnings of FERC Order 2000—both the stipulated “functions and characteristics” and the reserved authority to require RTO participation in order to receive market based rates or as condition for approving a merger.

There are parties interested in building new generating capacity. In fact, AMP-Ohio has undertaken an aggressive campaign to place small generators in our member communities to bolster system reliability and displace high-cost market purchases. We also are implementing a member and customer load curtailment program in anticipation of the likely constraints in the coming weeks.

However, as many public power systems nationally have experienced and are experiencing, incumbent utilities have an incentive to frustrate the interconnection of these new units in order to retain the supply shortage that drives up prices and favors their own generation additions. I know the difficulty of gaining interconnection agreements. Many of our member communities have fought for years against utility refusals to add second interconnections to promote system reliability. Transmission owners can send you on a wild goose chase of studies and reports that cause costly delay.

We believe that reliability will be improved by placing all uses of the transmission grid under a single set of rules. Currently, FERC has unclear jurisdiction over that portion of the transmission system used for providing bundled retail sales. While some will suggest that the current split jurisdiction assures reliability to “native load” customers, our view is that it creates a black box that prevents the open markets that are needed to benefit all consumers. If a utility says it has no transmission capacity available to others because it is needed for its own use, can we be sure that this isn't market manipulation in the name of reliability? Utilities have been known to reserve all of the transmission import capacity into their control area in the unlikely event that every single generation plant in the control area simultaneously shuts down.

I understand that the private utilities believe today's transmission constraints would be relieved if only FERC provided higher rates of return and other "incentives." Let me offer the following observations to debunk this demand for FERC "candy":

- Failing to relieve a transmission constraint allows a utility to charge substantial premiums on power sales from generation plants that represent the majority of utility investment. Transmission is a modest share of total utility plant investment. Bumping up rates of return a few basis points would have minimal impact on a utility's bottom line. Simple math suggests that the lack of "incentives" is not the principal impediment to relieving transmission constraints; rather, these constraints further a utility's profits.
- Transmission siting is and will remain a significant problem, especially in situations where the ultimate beneficiaries of expanding or building a line in one state are located in another state. We believe that giving independent RTOs planning authority for expanding transmission to serve an entire regional market is a solution.
- Transmission remains a monopoly function. As such, it should receive a regulated rate of return—the existence of which for many years did not seem to impede investment in utilities. Incentive returns are simply excessive profits.

Another aspect of ensuring reliability is an adequate and skilled workforce.

#### *Conclusion*

I read with interest the recent news reports about an internal FERC memo. The memo noted that, while transmission owners post voluminous data on the Open Access Same-Time Information System (OASIS), "it is nearly impossible for anyone to use OASIS to obtain pertinent data for overseeing transmission market behavior and assessing how well the markets are working." We hope this report bolsters our calls for reform outlined above.

AMP-Ohio, OMEA, TAPS and APPA stand ready to work with the Committee to promote legislation that advances both system reliability and effective competition in the electric utility industry.

Chairman BLILEY. Thank you, Mr. Gerken.  
Mr. Nemptzow.

#### **STATEMENT OF DAVID M. NEMTZOW**

Mr. NEMTZOW. Thank you for allowing the Alliance to Save Energy to testify.

I admire how you are trying to link the multiple crises of heating oil, natural gas prices and of electricity, and I brought, as part of the solution, a technology that can help solve all three of those simultaneous crises.

I am David Nemptzow, and I am President of the Alliance. We are a bipartisan, nonprofit coalition of business, government, environment and consumer leaders. Over 70 companies belong to the Alliance. We were first founded by Senator Charles Percy during the oil crisis of the 1970's, and we are now co-chaired by your colleagues, John Porter and Ed Markey.

Through much of the 1990's, many Americans told the Alliance not to worry about energy efficiency, that our efforts were falling on deaf ears because prices were so low, they were not registering. Of course, they are now registering, and consumers are facing a variety of crises—as we speak, \$2-plus a gallon gasoline; States and cities and regions may not have enough electricity to meet peak demand this summer; and of course, the hidden crisis of natural gas futures prices, which have doubled, and it is only June.

So it is a challenge to summarize what this means for American consumers, but I am sure they feel like they are on the TV show "Survivor." Instead of the multiple threats from this desert island, consumers are facing multiple assaults from energy crises, and I

think, like the TV show, they are wondering if they are still going to be standing by the end of the summer.

I won't review what the other experts have said about the mystery of gasoline prices in the Midwest and about what we have heard about electricity reliability and customers in the Bay Area of San Francisco and New York City and Detroit have already witnessed reliability problems this summer; and the Midwest, including your State, Mr. Chairman, may be next if things continue poorly.

I would like to suggest for your consideration—and I think Mr. Barton was particularly eloquent about this point earlier today—the problem that the Nation faces and that you have gone over is that there is a fundamental mismatch between supply growth and demand growth. And I brought my Monthly Energy Review in case you are going to ask more questions about the numbers in them this afternoon, Congressman.

We have a long-term problem, and in the 1990's we have seen rapid growth in the consumption of energy. Coal went up 14 percent; natural gas went up 15 percent in consumption; petroleum, 13 percent; electricity, 17 percent. And let me focus on gasoline: Gasoline consumption in this country went up 1.2 million barrels a day, and it is expected to be up 1.7 million barrels a day. That is the equivalent of adding another California worth of gasoline consumption if we continue business as usual, and that is a long-term problem that needs a long-term fix.

I will say briefly that energy efficiency has been an enormous part of this resource. If we look at energy efficiency contributions, we find that energy efficiency contributes 22 percent of the energy mix of this country. If we think what our energy use would be if it weren't for this smarter use of energy, that makes energy efficiency the No. 2 energy source after petroleum. There are many studies that support that and show the benefits.

Unfortunately, there are is not enough success. Let's look at the opportunities to continue to improve energy efficiency. We know cars are the biggest issue here. Unfortunately, new cars are less efficient than the cars going off the road. This is a trend that has been reversed, and this Congress has an opportunity to reverse that by supporting research and development and tax credits for efficient cars and, of course, CAFE fuel economy standards. The CAFE standards have already saved this country 3 million barrels a day in oil consumption. That has lessened demand, and future CAFE can decrease demand by 1.5 million barrels.

You talked earlier, Mr. Chairman, and your colleagues, about finger-pointing. Mr. Tauzin talked about assigning blame. There is plenty of blame to go around. But that also means that there is plenty of opportunity to go around, and the automakers have an opportunity to market fuel-efficient cars, as Honda and Toyota are doing, and the Big Three are behind them.

The State governments—Governor Pataki has been a leader in linking reliability to energy efficiency.

The administration certainly has responsibilities starting with their energy efficiency rules for air conditioners which are 8 years late; statutorily set by this committee, they are 8 years late. Perhaps this committee should ask the administration for a list of all

cost-effective energy efficiency measures, and ask for a status report on how they are doing.

Consumers have a responsibility. That is why I brought this programmable thermostat. You can lower your heating in the winter, air conditioning in the summer.

And in conclusion, I will say this Congress has an opportunity to increase research and development spending, to reverse the vote you had to kill the PNGV program, and to remove the CAFE rider and to pass the tax credits that are proposed by your colleague Congressman Bill Thomas.

Thank you again for having this hearing. I know that this committee works in a bipartisan fashion, and American consumers know that they will need your support in the future to meet these challenges.

[The prepared statement of David M. Nemtzw follows:]

PREPARED STATEMENT OF DAVID NEMTZW, PRESIDENT, ALLIANCE TO SAVE ENERGY

Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to testify before you today regarding the current crises in U.S. energy supply, demand, and distribution.

My name is David Nemtzw. I am the President of the Alliance to Save Energy, a bi-partisan, non-profit coalition of business, government, environmental, and consumer leaders dedicated to improving the efficiency with which our economy uses energy. Senators Charles Percy and Hubert Humphrey founded the Alliance in 1977; it is currently chaired by Senators Jeff Bingaman and James Jeffords as well as your colleagues, Representatives John Porter and Ed Markey.

Seventy companies and organizations currently belong to the Alliance to Save Energy. If it pleases the Chairman I would like to include for the record a complete list of the Alliance's Board of Directors and Associate members, which includes the nation's leading energy efficiency firms, electric and gas utilities, and other companies committed to cutting their energy bills.

Mr. Chairman, thank you for inviting me here today to speak about the consumer implications of the current energy crises. The Alliance to Save Energy was founded by Senator Charles Percy in 1977 in response to the oil shocks in that decade. Those events threw our nation into an economic recession and changed forever the way this nation thinks about its energy supply. But since that time, Mr. Chairman, we have been long on thought about energy policy and very short on action.

Large and small consumers of energy now face a double threat—they are paying skyrocketed prices for energy and have to address uncertainty of supply. Fundamentally, these threats have a single source. Demand for energy in this country is outstripping affordable and reliable supplies. Some industries and policymakers will call only for new supplies, when the fastest, cheapest, and cleanest way to help consumers is to cut demand by using energy more efficiently.

Mr. Chairman, the last attempt to consider a comprehensive energy policy was during the debate over the Energy Policy Act of 1992 (EPAct). That law made some significant decisions about energy policy. It began the deregulation of the electric system. It provided tax incentives for wind and solar energy, while giving Alternative Minimum Tax relief to independent oil and gas producers. EPAct expanded research and development of energy-efficient technologies and enacted a further round of consensus appliance efficiency standards, as well as putting new requirements on the federal government to reduce its energy use.

The absence of several provisions from EPAct also amounted to critical decisions about energy policy that have had huge implications. The legislation did not contain any provision to raise fuel economy standards for cars and trucks. By leaving this controversial issue untouched, Congress and the Administration decided to leave the issue of oil supply, gasoline price, consumption, and technology to chance—to let market winds blow as they might and let wishful thinking serve as the guiding force for energy policy.

One of the most recognizable phrases in American life, Mr. Chairman, alleged to have been uttered by George Washington, is that those who do not learn from history are doomed to repeat it. I heard this in elementary school, on up through graduate school. It rolls off the tongue with a certainty that is rarely challenged. The situation in which we now find ourselves with respect to fuel prices is an egregious

proof of the old maxim. Mr. Chairman, we spent the eight years since the passage of EPAct hoping, with our eyes closed and our fingers crossed, that oil prices would not rise, that OPEC would fail to regain its internal cohesion, hoping against hope that we would not have to pay politically or economically for our inability to protect ourselves from energy price fluctuations.

And for awhile Mr. Chairman, the skies were sunny. During the middle of the 1990s, gasoline hit its lowest real price since World War II. Attempts to raise our continued vulnerability to oil prices were met with, "don't worry, be happy." Five years ago, people told us at the Alliance to Save Energy that our attempts to promote energy-efficiency were falling on deaf ears because energy prices were so low that they didn't even register as a concern in public opinion polls.

The polls have changed, Mr. Chairman. Wishful thinking won't cut it with the American people now, as the polls now scream that gasoline prices are now their number one issue of concern. We face a variety of crises in energy now. \$2-3 dollar per gallon gasoline is only one. States and cities in vulnerable areas may not have enough electricity during hot weather this summer because the transmission system may not be able to support increased electric load and demand. The price of natural gas futures has doubled during the past four months, leaving significant uncertainty about what families and factories all over the nation will have to pay during the coming heating season. And what about the broader question of crude oil supply. Clearly, attempts to persuade OPEC to lift production curbs have not succeeded as an energy policy.

It's not hard to sum up the effects on consumers of this set of crises. They are paying much higher prices than usual, they are not happy about it, and the future holds nothing but uncertainty. Gasoline prices are a mystery in search of a scapegoat, adding significantly to household expenses. With respect to heating oil, natural gas, and electricity, what was once a certainty is no longer. Heating oil supply and price fluctuated wildly last winter. Will the same happen with natural gas at twice last year's price? Can consumers affordably heat their homes? Will there be enough power this summer on hot days to keep the lights on, the food fresh in the refrigerator, and computer systems safe from interruption?

In addition, Mr. Chairman, other factors have come to bear on the nation during the past decade. We have witnessed the rise of global climate change during the 1990s—the hottest decade on record by far. Not only is climate change a direct function of our reliance on fossil fuels and our uncontrolled demand for energy, a warmer climate is contributing directly to problems with electricity supply and distribution. With respect to climate change, wishful thinking has again been standard operating procedure.

Mr. Chairman, I come here making the same case that the Alliance made in 1992 during the Energy Policy Act. Energy-efficiency is a fundamental answer to each of these problems. It's time we wake up, Mr. Chairman, and look at our energy situation from the perspective of both supply and demand. The pure supply-side strategy has led us to the situation we are in now. Wishful thinking about how the market will provide has led us to real hardship for real American families, with only more to come down the road.

Energy-efficiency—in passenger vehicles, homes, offices, and industrial processes—can lead us to a much more stable energy future. And while investment in demand reduction leaves us less vulnerable to foreign cartels, price fluctuations, and supply disruptions, that investment puts dollars back into the pockets of Americans and improves our environment by reducing pollution. We can reduce the root cause of climate change at low cost by creating, building, and selling more efficient cars, trucks, computers, air conditioners, appliances, and industrial motors.

But we can only do this, Mr. Chairman, if we, as a nation, are willing to end energy policy by wishful thinking.

You have asked that I address price and supply issues regarding crude oil, gasoline, natural gas, and electricity. I will do this in turn after giving some background on energy efficiency and transforming effect it has had on the economy and the environment.

#### *Energy Efficiency as an Energy Source*

In order to gain a more full appreciation of the value of energy-efficiency and reducing demand, we have to think differently about our nation's energy supply. Too often, energy-efficiency is regarded as a "nice thing to do," or something that we would do "if we could." Mr. Chairman, energy-efficiency is a driving force in our economy. In fact, it supplies—or recycles—more energy to our economy than any source other than oil.

Energy Administration data for 1999 shows that energy-efficiency is responsible for contributing 21.8 percent of our available energy supply:

	Quads	%
Domestic and Imported Oil .....	37.7	30.8
Energy Efficiency .....	26.7	21.8
Natural Gas .....	22.0	17.9
Coal .....	21.6	17.6
Nuclear .....	7.7	6.3
Geothermal & Renewables .....	3.5	2.9
Hydro .....	3.4	2.8

These results indicate that fossil fuels had fallen to 66 percent of our nation's energy supply in 1999. In no way do we believe that fossil's share of our energy mix is insignificant, or less important when considered as a lower percentage share. However, getting into our heads that energy-efficiency measures provided more than one-fifth of our nation's energy supply takes some getting used to, and it is why it bears repeating in light of our current energy crises.

Mr. Chairman, slowly, but surely the facts are bearing out that energy-efficiency has been a transformational force in our nation's economy over the past 20 years. In order to make accurately informed decisions as a nation and as a government, we have to recognize not only the energy we use, the pollution we emit, and the dollars we spend for heat, transportation and industrial fuel. We must just as conscientiously account for the energy saved, the pollution avoided, and the dollars spent on more productive uses that have all been enabled by the use of energy-efficiency measures. Only then can we fully appreciate what an asset energy-efficiency has been to the U.S., and understand the huge remaining untapped potential of existing and future technology to reduce energy use.

#### *Energy-Efficiency as a Catalyst for Economic Growth*

Some critics attack the contribution of energy-efficiency over time by saying that after all the money we have spent on energy-efficiency, we are still using more energy than we did before. This analysis is simplistic and inaccurate. The correct measure of energy-efficiency in the economy is not overall energy use, but *energy intensity*. Energy intensity is the amount of energy we use per unit of economic output. So of course our nation has grown in population and economic activity—and therefore in aggregate energy use. However, our energy use per unit of GDP has dropped significantly. For example, during 1998, U.S. energy use rose 0.3 percent, but energy use per unit of GDP fell by 3.5 percent.

In March of this year, the Rand Corporation completed a study assessing California energy-efficiency programs, entitled "*The Public Benefit of California's Investments in Energy Efficiency*". In it, the authors conclude that without the realized reductions in energy intensity in California between 1977 and 1995—achieved largely due to energy-efficiency programs—the California economy (GSP) would have been 3 percent smaller in 1995 than it was.

They go on to say, "in other words, the benefit in 1995 to the California economy from improvements in industrial and commercial energy intensity since 1977 ranges from \$875 to \$1300 per capita...from 1977 to 1995, California utilities spent a cumulative total of \$125 per capita (1998\$) on energy-efficiency programs in the commercial and industrial sectors." In addition, the study finds that 1.6 million tons of nitrogen oxides, sulfur dioxide, carbon oxides, and smog-causing organic compounds were avoided by reductions in energy intensity.

The Rand study goes on to detail how energy-efficiency, by reducing energy intensity, creates more fertile ground for economic growth. A dollar spent on energy is an unproductive dollar. A dollar spent keeping the lights on for another hour is a less profitable investment than one spent on innovation or marketing. An economy with declining energy intensity is one that is ripe for continued economic growth. To fully appreciate the value of energy efficiency, we must undertake more efforts such as the recent Rand Corporation study to quantify its economic value to the nation.

#### *Crude Oil Supply*

EIA expects that crude oil prices will remain high through the remainder of the year, then begin to fall as supply begins to outpace demand. That is possible. But it is also possible, Mr. Chairman, that we are dealing with a new OPEC. Soon after the 1978 oil embargo, we saw OPEC fall apart as an effective organization and lose its ability to dominate world oil prices. This time, OPEC decided to squeeze consuming nations enough to jack up prices, then relax the pressure a little less. Mr. Chairman, just that gentle squeeze by OPEC now has this nation in crisis.

If you were the oil ministers of OPEC, and the price of your lifeblood just increased to the highest point in more than 20 years, I think that you would feel that the tactic had worked. You might even try to push it further, gradually squeezing the oil consuming nations more and more tightly. Mr. Chairman, the EIA forecast for lower prices next year are completely dependent on OPEC significantly increasing production. I don't believe we can afford to count on this happening.

Our main uses for oil, Mr. Chairman, are for transportation and home heating. Obviously, transportation is by far the greatest use. Our dependence on foreign supplies has grown to well over 50 percent and is likely to top 60 percent during this decade. While important on an environmental level, the argument over whether to drill in the Arctic National Wildlife Refuge is nearly irrelevant for energy policy. At best, it is only a stopgap measure that might yield the nation a few weeks worth of oil. Our domestic production of oil cannot effectively hold off increasing demand. Making domestic production the issue is no longer a credible way to address national energy policy. We must reduce our thirst for petroleum.

#### *Gasoline Price Increases*

The fuel economy of automotive fleets sold in this country peaked in 1988 at 28.5 miles per gallon. Now, cars going off the road and out of service are more efficient than the ones coming on. At a time when gas prices are high and looking to stay high, our fuel efficiency is moving in the wrong direction.

The last major push for an increase in CAFE standards came in 1991. The political might of the auto companies was sufficient to put down that effort, and the auto companies themselves became perhaps the chief proponent of the strategy of energy policy by wishful thinking. It worked well for them, because the policy of wishful thinking allowed the auto industry to increase the size and performance of the average vehicle, while decreasing fuel economy, all with the cooperation of the federal government. Now American consumers are faced with prices two times the amount they paid for a gallon of gasoline a year ago. And chances are great that they drove to the pump in a sport utility vehicle that falls well below the CAFE average.

The auto industry has traditionally argued that they could not comply with an increase CAFE because adequate technology did not exist. They claimed it would mean less safe cars, cars that are too small, cars that nobody wants to buy. In part as a response to these complaints, the federal government created the Partnership for a New Generation of Vehicles (PNGV), a joint public private-partnership with the U.S. auto manufacturers to develop auto technology with the goal of producing a car that carries the size and safety level of a 1993 Ford Taurus, but that gets 80 miles to a gallon of gas. The federal input to PNGV has been roughly \$1.5 billion over the 7 years of the program.

The PNGV program has spurred a worldwide race in auto technology toward cleaner, more efficient cars. The first result of that competition has been the introduction in U.S. showrooms of gasoline-electric hybrid cars—specifically the Honda Insight and the Toyota Prius that can travel more than 70 and 60 miles per gallon respectively. In addition, each of the U.S. manufacturers has created a prototype car intended for full production within the next three years.

Further, PNGV has made strides in emissions reduction, advanced lightweight materials for safety, and other areas. It is time for taxpayers to start getting back their investment in auto technologies that many believed the auto industry should have achieved on its own. Because of PNGV, the technology and safety should be off the table as impediments to increasing CAFE. PNGV sought to leapfrog the modest increase in CAFE sought in 1991. With these hurdles out of the way, it is high time to relieve what has become a crisis situation for the nation—and support an increase in CAFE standards to at least 40 miles per gallon.

Driving habits can have a great effect on the fuel economy of individual vehicles. For consumers to conserve fuel when they drive:

- avoid jackrabbit stops and starts
- drive at the speed limit; fuel economy falls as speed rises
- plan trips in advance and map out the shortest route
- call your local domestic auto dealer and ask when they expect to be selling gasoline-electric hybrid cars
- urge Congress to increase CAFE standards

#### *Natural Gas*

This country has bet a lot on natural gas. The vast majority of new electric generation planned in the states will be powered by natural gas. Most new homes going on the market this year are heated by natural gas.

All of a sudden, natural gas supply is proving to be remarkably fragile. The price per thousand cubic feet has roughly doubled since the beginning of the year. Storage



levels in this injection season are 20 percent lower than last year. EIA speculates that imports may rise significantly, and that fuel oil will become a cheaper source of fuel to generate electricity until late next year.

The wager that we have made on natural gas as the energy source of the future now needs to be reconsidered in a climate of major price instability. As states have deregulated their electric systems, many have opted for set pricing in a first stage of transition. Many of these decisions were made in a climate of cheap, stable, natural gas prices. It will be interesting to see whether a high, unstable price will destabilize any existing state restructuring arrangements.

By far, the most important consideration, however, is the effect that higher prices will have on homeowners that heat with natural gas. Far more Americans heat with gas (52 percent) than fuel oil (10 percent). If price and supply constraints sent heating oil users into a crisis this past winter, a natural gas spike could send shock waves orders of magnitude larger both economically and politically.

For natural gas consumers, it would be wise to enter the heating season with your home as fully weatherized as possible. Some steps to take include:

- weatherstrip windows and doors to prevent leakage;
- install a setback thermostat to automatically turn the heat down during work and other times you regularly leave the house;
- make sure your home has efficient windows and is insulated as fully as possible;
- always look for the Energy Star label when buying heating equipment and other appliances.

#### *Electricity Reliability*

Roughly half of the states have now passed legislation to restructure their utility systems, Mr. Chairman. Some states have fashioned plans for legitimate competition, while others have merely cemented the market position of existing utilities for the near term. There is currently little uniformity in the ability of generators to sell and distributors to purchase power off the grid in states and major metropolitan areas.

The existing transmission system, created to satisfy regional and local demands, will not effectively serve as the power superhighway envisioned by a brave new world of electric competition. Transmission bottlenecks have created the possibility of significant interruptions in service during periods of peak summer demand, yet transmission upgrades could take many years before relieving vulnerable areas.

Mr. Chairman, we can all agree that attempts to fashion a truly comprehensive federal restructuring bill now seem dead for the year. While the Senate could still pass a bill creating a reliability governance body, and you could report your transmission discussion draft, it will not materially affect this summer's potential blackouts, brownouts, and price spikes. In fact, I don't believe that state and local public officials should plan on relief from federal legislation anytime soon. That is not because it can't or won't happen—although it still remains a daunting political task—but because state and local officials must start thinking about what they can do to reduce their risk of power interruptions and shortages.

The federal restructuring debate has thus far been very long on attention to the supply side of the equation, and short on focus on the demand side. Mr. Chairman, as we see it, we aren't looking at a power shortage as much as we are faced with highly inefficient air conditioning. If we cut peak demand, we are addressing the heart of reliability problems—not focusing on building a system to specifications that are only required a few times a year. Demand side options generated significant economic savings during the past decade. Demand management and energy-efficiency accounted for reduction of 30,000 MW peak demand during the 1990s through state mandated and voluntary utility measures. Roughly half of that came from energy-efficiency options. Mr. Chairman, two-thirds of that amount was achieved for between 2 and 3 cents a kilowatt hour, a price that is looking better every day with increased natural gas prices.

But, Mr. Chairman, those energy-efficiency investments are drying up at just the time that we need them most. Utility investments in energy-efficiency have fallen by more than 70 percent since 1993. The reason for this is documented, as utilities saw the onset of competition and became less sure of their future market, their ability to benefit from longer term investments in efficiency became less certain. However, if these cheap, highly effective reductions in peak demand had continued throughout the nation, we might be facing a considerably more stable situation relative to reliability.

State and local officials have ample motivation to undertake demand side measures to lessen their vulnerability to shortages and other incidents. The greatest might simply be self-preservation. When the lights go out, Mr. Chairman, people get mad. And they aren't going to be mad at the head of the RTO, or the Chairman

of the FERC. They'll be mad at their elected representatives for not protecting them from such a crisis. With uncertainties about when transmission relief will come to reliability hot spots, unstable conditions may realistically remain for years to come. States, cities, towns, and co-ops—especially entities that are transmission dependent—should take a hard look at how they can reduce peak demand.

Take the city of Austin, Texas. The Austin City Council took matters into its own hands several years ago and instituted an aggressive set of incentives for energy-efficiency. These included new building design, retrofit of existing buildings, and rebates for the purchase of energy-efficient air conditioners. Since the early 1990s, Austin has managed through several tough cooling seasons without having to buy a single kilowatt off the grid, fully avoiding any interruptions or other incidents, and avoiding 402 megawatts of peak demand. (As the local utility, they also avoided having to build a 400 megawatt coal plant, with its attendant sulfur, nitrogen, mercury, and carbon emissions.)

My advice to Governors, Mayors, City Councils, and others is: use your surplus to reduce electricity demand. These investments pay off in spades as we find in the Rand study of California. You attack the root of reliability problems, peak demand. You reduce pollution for your community. Finally, demand reduction serves as insurance against the delays of the legislative, permitting, siting, and construction processes for new generation and transmission.

We urge Congress to help states to make just these kind of investments. From the outset of this debate, we have advocated the creation of a public benefits fund that would match state expenditures on a variety of public goods that states used to be able to compel utilities to do. Because competition has limited states' ability to make utilities invest in such things as universal and affordable service, energy-efficiency, and renewable energy, a public benefits fund would give them assistance in bolstering their state or city from the uncertainties of reliability and fluctuating prices.

New power plants and beefed-up wires are important parts of the blackout-prevention solution. But energy efficiency is not only cheaper in most cases, it also saves consumers money on energy bills and reduces air pollution. It can be the least expensive form of blackout insurance; let's not wait to buy our policies until the next blackout hits.

**Consumers** can use a wide variety of measures to reduce their own electricity use:

- Buying Energy Star room air conditioners and central air conditioners, windows and other appliances.
- Getting professional service on existing air conditioning systems to make sure they run at peak efficiency.
- Cleaning air conditioning system air filters every month to keep systems running efficiently.
- Using programmable thermostats to raise temperature settings a few degrees during weekday afternoons.
- Choosing to run clothes washers, dishwashers, other electric appliances outside of peak hours (typically afternoon-early evening)

**Utilities** can help by:

- Promoting Energy Star air conditioning, windows, and other Energy Star appliances.
- Promoting AC service and testing programs to bring existing systems up to par.
- Offering load control and thermal storage incentives to customers.

**The federal government** can help by:

- Proposing a strong new efficiency standard for residential air conditioners this summer.
- Including a public benefits fund in electric utility restructuring legislation to support efficiency programs.
- Increasing funding for Energy Star and other efficiency programs at EPA and the Department of Energy.

**State and local governments** can help by:

- Creating public benefits funding for energy efficiency in utility deregulation legislation.
- Working with the federal government, private industry, and utilities to promote Energy Star and other efficiency programs.
- Adopting the International Energy Conservation Code for new buildings.

Chairman BLILEY. Thank you, Mr. Nemtsov.  
Mr. Pillari.

**STATEMENT OF ROSS J. PILLARI**

Mr. PILLARI. Thank you, Mr. Chairman. My comments are directed principally at the impact of the recent supply disruptions and dislocations in the Midwest, but also at the nature of the supply situation as we look forward to the summer months.

While the Midwest region is the most recent example of gasoline price volatility around a supply/demand imbalance, we have seen similar market conditions in California and New England for heating oil, all in the last 12 months. Each of these situations centers around a temporary supply/demand imbalance.

In the last 2 weeks, my company has participated in extensive discussions with the DOE, EPA, and most recently at a briefing chaired by the Speaker of the House of Representatives. At these discussions, many have outlined the pipeline outages, low inventory levels, high demand, and other exacerbating issues that have led to tight supply in the Midwest. I will not repeat those. Instead, I would prefer to explain how BP Amoco has responded to the market conditions in the Midwest and how we have met the needs of our customers.

During the past several months, we have supplied all of our commitments for both conventional and RFG fuels. We have operated our refinery in the Midwest at maximum capability and to maximize gasoline output. This includes producing higher volumes of RFG fuels than last year. We have purchased additional supplies from nontraditional and remote sources. We have shipped blend stocks to the Midwest from BP Amoco refineries in other regions. We have met the environmental regulations in all of our markets, including St. Louis, where we did not utilize the temporary waiver granted by the EPA.

As we look out into the summer months, we expect to meet our commitments to our customers and have taken steps to supply the increasing demand for transportation fuels in the Midwest and other regions of the United States.

Under normal operating conditions, the consumers can expect adequate supplies this summer. We also expect to be able to meet our continuing commitment to cleaner fuels throughout the summer, including our commitment to continue to introduce cleaner, lower sulfur fuels in markets that are not yet subject to regulatory requirements.

However, as we think about the coming months, the supply system in the United States is finely tuned and as demand for products during summer months continues to increase, the supply infrastructure has become very stressed. Any outages, particularly affecting pipelines or refineries, can cause severe product shortages, resulting in tight supplies and short-term price volatility in the marketplace as it seeks to balance supply and demand.

To minimize the effects of any disruption, we continue to operate our refineries at high levels of production, and inventories are building to normal levels. However, nobody can predict outages, shutdowns, excess demand or other factors that could upset the balance of supply and demand as we move through the summer.

As a final point, we believe the conditions in the marketplace reflect the balancing of supply and demand. We have seen market prices in the Midwest react to supply disruptions, and we are see-

ing them react again as supply grows in the affected areas of the Midwest. While it would be imprudent to predict what will happen this summer, we are doing everything we can to meet our supply commitments during the peak driving season.

Thank you.

[The prepared statement of Ross J. Pillari follows:]

PREPARED STATEMENT OF ROSS J. PILLARI, GROUP VICE PRESIDENT FOR MARKETING,  
BP AMOCO GROUP

Good morning. My name is Ross Pillari and I am Group Vice President for Marketing for the BP Amoco Group. I am pleased to appear here this morning and speak on behalf of my company about the issue of "Summer Energy Concerns for the American Consumer". BP Amoco is a supplier of fuels for both transport and power in the United States and is a supporter of clean fuel initiatives.

My comments this morning are directed principally at the impact of the recent supply disruptions and dislocations in the Midwest and the nature of the supply situation as we look forward into the summer months. While the Midwest region of the USA is the most recent example of gasoline price volatility around a supply/demand imbalance, we have seen similar market conditions in California and in New England for heating oil, all in the last 12 months. Each of these situations centers around a temporary supply/demand imbalance.

In the last two weeks my company has participated in extensive discussions with the Department of Energy, Environmental Protection Agency, and most recently at a briefing chaired by the Speaker of the House of Representatives. My company along with others from the energy industry have outlined the pipeline outages, low inventory levels, high demand, and other exacerbating issues that have led to tight supply in the Midwest. I do not plan to repeat these facts this morning, but would be happy to take questions on any of these specific issues.

Instead, I would prefer to explain how BP Amoco has responded to the market conditions in the Midwest and how we have met the needs of our customers. This, I believe will give us insight into how the summer supply/demand concerns can be met.

During this past several months:

- we have supplied all of our commitments for both conventional and RFG fuels;
- we have operated our refinery in the Midwest at maximum capability and to maximize gasoline output. This includes producing higher volumes of RFG fuels than last year;
- we have purchased additional supplies from non-traditional and remote sources;
- we have shipped blend stocks to the Midwest from BP Amoco refineries in other regions;
- we have met the environmental regulations in all of our markets, including St. Louis, where we did not utilize the temporary waiver granted by the EPA.

As we look out into the summer months, we expect to meet our commitments to our customers and have taken steps to supply the increasing demand for transportation fuels in the Midwest and other regions of the United States. Under normal operating conditions the consumers can expect adequate supplies this summer. We also expect to be able to meet our continuing commitment to cleaner fuels throughout the summer, including our commitment to continue to introduce cleaner, lower sulfur fuels in markets that are not yet subject to regulatory requirements.

However, as we think about the coming months, the supply system in the USA is finely tuned, and as demand for products during the summer months continues to increase versus prior years, the supply infrastructure has become very stressed. Any outages, particularly affecting pipelines or refineries, can cause severe product shortages, resulting in tight supplies and short term price volatility in the marketplace as it seeks to balance supply and demand.

To minimize the effects of any disruption, we continue to operate our refineries at high levels of production, and inventories are building to normal levels. However, nobody can predict outages, shutdowns, excess demand or other factors that could upset the balance of supply and demand as we move through the summer.

As a final point, we believe the conditions in the marketplace reflect the balancing of supply and demand. We have seen market prices in the Midwest react to supply disruptions and we are seeing them react again, as supply grows in the affected areas in the Midwest. While it would be imprudent to predict what will happen this summer, we are doing everything we can to meet our supply commitments during the peak driving season.

I would be pleased to take questions.

Mr. TAUZIN [presiding]. Thank you.

Mr. Ports.

#### STATEMENT OF MICHAEL PORTS

Mr. PORTS. Good afternoon, Mr. Chairman and members of the committee. My name is Mike Ports. I am President of Ports Petroleum Company, Inc., an independent motor fuels marketer headquartered in Wooster, Ohio. Ports Petroleum owns and operates 70 retail motor fuels outlets in 12 States in the Midwest and the Southeast. I appear before this committee today as a representative of the National Association of Convenience Stores, NACS, and Society of Independent Gasoline Marketers of America, SIGMA.

As an independent motor fuels marketer in the Midwest, which has experienced some of the highest gasoline prices in history in recent weeks, I am familiar with the impact these price increases have on my business and on motorists. Four years ago the Senate Energy Committee held a hearing on the increase in retail gasoline prices that occurred during the spring of 1996. At that time, a representative of Independent Gasoline Marketers told that committee, and I quote, "The Federal and State governments regulate the gasoline refining and marketing industry with little or no thought given to costs, distribution difficulties or market efficiencies. Congress must acknowledge that future EPA and State actions, if the present course is followed, will lead to further market disruptions and higher gasoline prices at the pump."

His prediction could not have been more accurate. Over the past 8 years, Congress, State officials, and the Environmental Protection Agency have crippled what was previously one of the most efficient commodity distribution systems in the world—the United States fungible grade motor fuels distribution system. In short, we need to look no further than our Federal and State governments to pinpoint a principal cause of the current increase in retail gasoline prices. While this may not be a welcome message to this committee today, it is an accurate one.

The government witnesses at today's hearing offered various explanations for the recent increases in gasoline prices. EPA, and perhaps others, will seek to distance themselves from the cries of outraged consumers by blaming the oil companies for price gouging. While such statements may play well in the press, there is no evidence of such pricing collusion. It appears that EPA and the administration is more interested in demonizing an entire industry than holding an intelligent discussion of the real causes for the price increases.

There are very rational and much less sinister causes for the recent gasoline price increases: the elevated crude oil prices; the uncertainty caused by the Unocal patent case; pipeline breaks and power outages; the advent of the ever more stringent Phase II reformulated gasoline program, the RFG program's oxygenate mandates, which results in the balkanization of the country into ethanol RFG markets and nonethanol RFG markets and the continued fragmentation of the country's motor fuels distribution system by boutique fuels; the increasingly complex impact that the gasoline futures market and Wall Street traders have on wholesale and re-

tail gasoline prices; and historically low gasoline inventories. In reality, it is amazing, given repeated political and governmental interference in the motor fuels and marketing industry, that retail gasoline prices have remained as low as they have over the past decade.

However, as the saying goes, there is no free lunch. It should not be surprising to policymakers that after tens of billions of dollars in environmental compliance costs borne by refiners and marketers, the complete fragmentation of the motor fuels distribution system and the politically motivated diverse motor fuels formulations, there is a price to pay, a price that ultimately must be paid by consumers of gasoline and diesel fuel.

As long as the motor fuels refining and distribution system works perfectly, supply and demand stay roughly in balance and retail prices remain relatively stable. However, whenever a refinery goes down, overseas crude oil production is reduced, the weather disrupts smooth product deliveries or a new regulatory curve ball is thrown at the motor fuels refining and marketing industries, we do not have the flexibility to react and counterbalance these forces.

As a result, NACS and SIGMA predict that wholesale and retail gasoline and diesel fuel price volatility will become the norm, not the exception, as we have seen in California. Current high retail gasoline prices in the Midwest and elsewhere already show signs of retreating. However, in NACS's and SIGMA's opinion, it is only a matter of time before the next supply and distribution crisis occurs.

In sum, if we are looking for a scapegoat for our gasoline prices, then we will learn little today. If we try to fix the current situation with more government intervention, we will only make the situation worse. NACS and SIGMA conversely urge this committee and this Congress to understand the diverse and complex origins of the current increases in gasoline prices. These origins are not simple or even inconvenient—they do not fit nicely into a sound bite. But they are accurate and they are here for the foreseeable future.

Thank you for the opportunity to present this testimony, and I will be pleased to answer any questions that I have raised.

[The prepared statement of Michael Ports follows:]

PREPARED STATEMENT OF MICHAEL PORTS, PRESIDENT, PORTS PETROLEUM, INC.,  
REPRESENTING THE NATIONAL ASSOCIATION OF CONVENIENCE STORES AND THE  
SOCIETY OF INDEPENDENT GASOLINE MARKETERS OF AMERICA

Good morning, Mr. Chairman and Members of the Committee. My name is Mike Ports. I am President of Ports Petroleum, Inc., an independent motor fuels marketer headquartered in Wooster, Ohio. Ports Petroleum owns and operates 70 high volume retail motor fuels outlets in 12 states from Ohio to Nebraska, south to Mississippi, and east to Georgia.

I appear before this Committee today as a representative of the National Association of Convenience Stores ("NACS") and the Society of Independent Gasoline Marketers of America ("SIGMA"). NACS is a national trade association of more than 2,300 companies that operate over 60,000 convenience stores nationwide with some 750,000 employees. Over 75 percent of NACS' member companies sell motor fuels. SIGMA is an association of approximately 260 motor fuels marketers operating in all 50 states. Together, SIGMA members supply over 28,000 motor fuel outlets and sell over 48 billion gallons of gasoline and diesel fuel annually—or approximately 30 percent of all motor fuels sold in the nation last year.

I appreciate the invitation to appear at this hearing to present testimony on the recent increases in retail gasoline prices. As an independent motor fuels marketer in the Mid-West, which has experienced some of the highest gasoline prices in his-

tory in recent weeks, I am all too familiar with the impact of these price increases both on my business and on motorists.

Four years ago, the Senate Energy Committee held a hearing on the increase in retail gasoline prices that occurred during the Spring of 1996. At that time, a representative of independent gasoline marketers told that Committee: "The federal and state governments regulate the gasoline refining and marketing industry with little or no thought given to costs, distribution difficulties, or market efficiencies. Congress must acknowledge that future EPA and state actions, if the present course is followed, will lead to further market disruptions and higher gasoline prices at the pump."<sup>1</sup>

His prediction could not have been more accurate. Over the past eight years, Congress, state officials, and the Environmental Protection Agency have crippled what was previously one of the most efficient commodity distribution systems in the world—the United States' fungible grade gasoline distribution system. Repeatedly over the past eight years, these government officials and agencies have combined to fragment the nation's gasoline markets into dozens of distinct areas. This fragmentation has discarded the traditional system of providing affordable gasoline to American consumers, replacing it with a patchwork of different gasoline markets with little or no thought given to supply and distribution logistical concerns.

In short, we need look no further than our federal and state governments to pinpoint a principal cause of the current increase in retail gasoline prices. While this may not be a welcome message to this Committee today, it is an accurate one.

The government witnesses at today's hearing will offer various explanations for the recent increases in recent gasoline prices. EPA, and perhaps others, will seek to distance itself from the cries of outraged consumers by blaming the oil companies for "price gouging." While such statements may play well in the press, there is no evidence of such pricing collusion. Indeed, such demagoguery is clearly motivated by election year political considerations and a desire to avoid any hint of responsibility for the current crisis. After all, it is easier to demonize an entire industry than to hold a thoughtful discussion of the real causes for the price increases.

EPA's witness also may recite its statistics regarding the relatively low incremental cost for manufacturing the new motor fuels that have been mandated over the past eight years. However, EPA's numbers, and the Agency's assurances to Congress and others, are relevant only if there is sufficient supply of these motor fuels to meet the markets' demands. While summertime Phase II RFG may cost only five cents more per gallon for a refiner to produce, if supplies of this gasoline fall short of demand in a particular market like Chicago or St. Louis, then the price of this product will rise high enough to attract the necessary supplies from other markets. In short, EPA's manufacturing costs statistics are irrelevant if the gallons of gasoline do not or cannot reach the appropriate markets.

There are other, very rational and less sinister causes for the recent gasoline price increases, including elevated crude oil prices, the uncertainty caused by the Unocal patent case, pipeline breaks and terminal outages, and the advent of the ever more stringent Phase II reformulated gasoline program. All of these causes contributed to the current price increases. NACS and SIGMA also note that the following additional causes must be examined as well when considering why retail gasoline prices are so high in some areas of the country:

- the RFG program's oxygenate mandate, which most would agree serves no environmental purpose and results in the balkanization of the country into ethanol RFG markets and non-ethanol RFG markets;
- the continued fragmentation of the country's motor fuels distribution system into scores of different areas with different gasoline formulations;
- the increasingly complex impact that the gasoline futures market, and Wall Street traders, have on wholesale and retail gasoline prices; and,
- historically low gasoline inventories, caused by the destruction of the gasoline refining and marketing industry's confidence that EPA and state governments will place good public policy and good economics over short-term and parochial political considerations.

In reality, it is amazing, given the repeated political and governmental interference in the gasoline refining and marketing industry, that retail gasoline prices have remained as low as they have over the past decade. These historically low prices are, in fact, a tribute to ingenuity and resiliency of the gasoline refining and marketing industry. We believe the FTC will come to the same conclusion regarding the recent increase in gasoline prices because they will look at the evidence, rather

<sup>1</sup> Testimony of Thomas L. Robinson before the Senate Committee on Energy and Natural Resources, May 9, 1996.

than the opinion polls, to discover what has happened. We intend to help them gather that evidence.

However, as the saying goes, there is no free lunch. It should not be surprising to policy makers that after tens of billions of dollars in environmental compliance costs borne by refiners and marketers, the complete fragmentation of the motor fuels distribution system, and the politically-motivated diverse gasoline formulations, there is a price to pay—a price that ultimately must be paid by consumers of gasoline and diesel fuel. As long as the motor fuels refining and distribution system works perfectly, supply and demand stay roughly in balance and retail prices remain relatively stable. However, if a pipeline or refinery goes down, overseas crude oil production is reduced, the weather disrupts smooth product deliveries, or a new regulatory curve ball is thrown at the motor fuels refining and marketing industries, we do not have the flexibility to react and counterbalance these forces. As a result, NACS and SIGMA predict that wholesale and retail motor gasoline and diesel fuel price volatility will become the norm—not the exception.

Californians have become somewhat accustomed to motor fuels price volatility over the past five years because California is in fact the laboratory for the fuels programs that EPA currently is forcing on the rest of the country. When a refinery in California goes down, or a pipeline breaks, the impact on retail prices is almost immediate. In California, retail gasoline prices can increase by 40 cents per gallon within two or three days. When retail prices get high enough to attract supply from other markets, then eventually the supply shortage is alleviated and retail prices start to fall.

Current high retail gasoline prices in the Mid-West and elsewhere already show signs of retreating as crude oil production increases, product shortages are replenished, and wholesale prices to marketers come down. However, in NACS' and SIGMA's opinion, it is only a matter of time before the next supply and distribution crisis occurs. It may take another four years, or it may occur later this year.

And EPA is not done with the nation's motor fuels markets yet. Just last month, EPA proposed a restrictive regulatory scheme for diesel fuel—the fuel that moves most of the commercial transportation in this country. If EPA's plan for diesel fuel has a similar impact that its programs for gasoline have had on overall supplies and the motor fuels distribution system, then retail price volatility will spread from the gasoline markets to the diesel fuel markets—with potentially severe consequences for our nation's economy.

In sum, if we are looking for a scapegoat for high gasoline prices, then we will learn little today. If we try to fix the current situation with more government intervention, we will only make the situation worse. NACS and SIGMA, conversely, urge this Committee and this Congress to understand the diverse and complex origins of the current increases in gasoline prices. These origins are not simple or even convenient—they do not fit nicely into a sound bite. But they are accurate and they are here for the foreseeable future.

While consumers generally have responded to public polling that they are willing to pay more for gasoline and diesel fuel to have cleaner air, the recent supply crises and price spikes—and the resultant howls of protest from consumers and elected officials—give rise to significant questions regarding the public's support for environmental programs that will lead to substantially higher retail prices for gasoline and diesel fuel and ultimately harm the nation's continued economic expansion.

Thank you for the opportunity to present this testimony. I would be pleased to answer any questions my testimony has raised.

Mr. TAUZIN. Thank you, Mr. Ports.  
Mr. Thompson.

#### STATEMENT OF JERRY THOMPSON

Mr. THOMPSON. Thank you. I am Jerry Thompson, Senior Vice President of CITGO Petroleum, headquartered in Tulsa, Oklahoma; and according to the latest data available, it is the second largest marketer of gasoline in the United States.

I am pleased to have the opportunity to speak before this committee about gasoline supply and price as well as the overall issue of providing the energy that is so critical to the American people and to this Nation's economic well-being.

We at CITGO empathize with those families whose household budgets have felt the impact of rapidly rising gasoline prices in the



Chicago, Milwaukee and other Midwest markets. It is our sincerest hope that a sound national energy policy emerges from hearings such as this to avoid future recurrences.

Unfortunately, the American people's ability to depend on gasoline where they need it, when and how they need it, is in jeopardy as a result of our Nation's regulatory and energy policy. The gasoline situation we are discussing today is a classic study of the relationship of supply, demand and price. In a free market system, the price of a commodity like gasoline is not so much the cost of manufacturing and delivering the finished product, but rather the relationship between the consumer's demand for the product and the manufacturer's ability to supply it to the marketplace.

In the current situation, the price of gasoline in the Midwest was driven up by the inability to manufacture and deliver the products to the marketplace to meet consumers' demand. Once again, the consumer has been forced to pay for hidden impacts of actions taken over the course of several decades, primarily by the EPA.

We agree with the findings and conclusions of the June 16, 2000, Congressional Research Service memorandum which attributes the price increase to the following five factors: one, higher crude oil prices. Crude oil costs have risen by 30 cents a gallon compared to 1 year ago and by 48 cents a gallon compared to a year-and-a-half ago.

Two, special fuel reformulations. About 30 percent of the gasoline sold in the United States is RFG. In the Midwest, refiners primarily use ethanol to provide the mandated oxygen content. This means that RFG from the rest of the country cannot be shipped to the Midwest if additional supplies are needed; refiners must ship a special blend stock called RBOB, which is very difficult to manufacture.

During the first 2 months of this year, our Lamont, Illinois, refinery produced more RBOB than in 1999. But as we began making a new Phase II RBOB, we quickly fell behind last year's production because it was more difficult to blend than we had anticipated. It has taken until June for us to learn how to efficiently blend this product and catch up with last year's RBOB production levels.

No. 3, low inventories. To convert to the tighter specification of the new summer grade RFG II, refiners, as well as terminals, virtually emptied their storage tanks to minimize the time required to convert the tanks from winter grade to summer grade, to be ready for the summer driving season. On their Web site, the Energy Information Agency states that at current inventory levels, there is the equivalent of 2 days of consumption in available inventory. When supplies are this low, any disruption in supply results in price increases.

No. 4, operational problems. Two pipelines serving the upper Midwest have experienced operational problems at the time when refinery and terminal inventories were low. This prevented these inventories from being replenished. This was further exacerbated when two refineries in the Chicago area were temporarily shut down. Both of these refineries' outages reduced the availability of gasoline in the Midwest.

The Unocal patent has caused several refiners to scale back our RFG production to avoid patent infringement.

The inescapable fact is that the U.S. pipeline and distribution system was designed to handle a half a dozen grades of gasoline. As shown partially on this chart, today it has to cope with more three dozen grades of “boutique” gasoline. No single refinery can manufacture all these fuels, so they have to be shipped all over the country to where they are needed. Each of these fuels has to be kept segregated, separate pipelines and shipments and separate compartments. Daniel Yergen has called this the “balkanization of America.” Our Nation can no longer substitute fuels from one area of abundant supply into areas of insufficient supply because they are literally different fuels. A patchwork of fuels mandated by different State regulators has unintentionally constrained manufacturers’ ability to refine and supply gasoline to the marketplace.

The Midwest, which includes the Chicago and Milwaukee markets, is a net consumer of gasoline. In 1998, the Midwest consumed 475,000 barrels a day, more gasoline than the refineries in that area could manufacture; 350,000 barrels a day had to be shipped from the Gulf Coast, primarily by pipeline, and another 160,000 barrels a day of gasoline had to be shipped from the East Coast. It is clear to see that a supply problem in the Midwest, the Gulf Coast or the East Coast has a definite impact on product pulled from one region to fill shortages in another.

The important point to recognize is that the root cause of the current price and supply situation stems from the unfortunate fact that this Nation’s only energy policy is driven by the Environmental Protection Agency. In reality, it is not a policy, but a patchwork quilt of regulations and requirements which has been added to every year since the Clean Air Act was passed in 1970.

We are already faced with the next wave of requirements, diesel fuel. The end result of these and a host of other EPA regulations staring us in the face ensure that more refineries, unable to afford the capital investment required to comply with these regulations, will drop out, further tightening supply. Clearly, unless we develop a cohesive energy policy, one that considers this Nation’s energy needs, the sustainability of affordable energy in America is in serious jeopardy.

[The prepared statement of Jerry Thompson follows:]

PREPARED STATEMENT OF JERRY E. THOMPSON, SENIOR VICE PRESIDENT, CITGO  
PETROLEUM CORPORATION

Good morning/afternoon.

I am Jerry Thompson, Senior Vice President of Development and Technological Excellence of CITGO Petroleum Corporation. CITGO is a U.S. corporation headquartered in Tulsa, Oklahoma. Our roots extend back to the early 1900’s as Cities Service Company. While our products are marketed throughout most of the U.S., we primarily serve those regions east of the Rockies. We own and/or operate a network of modern refineries in Houston, Corpus Christi, Texas, Lake Charles, Louisiana, and Lemont, Illinois. In addition, we own asphalt refineries in Paulsboro, New Jersey and Savannah, Georgia. To get our products to where the American public needs them, we own one of the nation’s most extensive systems of petroleum terminals. According to the latest data available, CITGO is the second largest marketer of gasoline in the United States with 10.3 % share of the market.<sup>1</sup>

I am pleased and honored to have the opportunity to speak before the House Commerce Committee about gasoline supply and price, as well as the overall issue of providing the energy that is so critical to the American people and to this nation’s

<sup>1</sup>National Petroleum News—*Market Facts* 1999, Mid-July, 1999

economic well-being. CITGO and the rest of the refining, marketing and transportation industry share your concern regarding the current issues. CITGO empathizes with those families whose household budgets felt the impact of the rapidly rising gasoline prices in the Chicago and Milwaukee markets. It is our sincerest hope that a sound, cohesive national energy policy emerges from hearings such as this. What America needs is an energy policy that ensures the quality of life that the American people expect and deserve.

I'd like first to discuss the key factors contributing to the current situation. I will conclude by discussing a positive and constructive path forward based on solid economics—one that ensures the clean, affordable fuels that are necessary to this nation's well-being.

The oil and gas industry has done an excellent job of providing cleaner fuels at an affordable price. As a result, Americans have access to inexpensive transportation fuels; a fact that has contributed to our overall high standard of living. In fact, using constant 1999 dollars, the average retail price of gasoline, including taxes, decreased from \$2.27 a gallon in 1918 to \$1.16 a gallon in 1999, according to research by Cambridge Energy Research Associates, (CERA) one of the world's leading energy research firms.<sup>2</sup>

Unfortunately, American's ability to depend on gasoline where they want it, when they want it and how they want it is in jeopardy as a result of our energy and regulatory policy. The gasoline situation we are discussing today is a classic study of the relationship of supply, demand and price. In a free market system, the price of a commodity like gasoline is not so much a factor of the cost of manufacturing and delivering the finished product, but rather the relationship between consumers' demand for a product and manufacturers' ability to supply it to the marketplace. In the current situation, the price of gasoline in the Midwest was driven up by the inability to manufacture and deliver the products to the marketplace to meet consumers' demand. Once again, the consumer has been forced to pay for the hidden impact of actions taken over the course of several decades—primarily by the EPA.

For background, I want to briefly discuss the key factors that have contributed to the current situation. In their June 16, 2000, memorandum,<sup>3</sup> the Congressional Research Service attributes the price increase to the following five factors:

- **Higher crude oil prices.** Refiners' crude acquisition costs have risen by the equivalent of 30 cents per gallon as compared to one year ago and 48 cents per gallon as compared to year and a half ago.
- **Special Fuel Formulations.** Reformulated gasoline or RFG is required in numerous areas designated by EPA as ozone non-attainment areas. About 30 percent of the gasoline sold in the United States is RFG, including the Chicago and Milwaukee markets. In the Midwest, however, refiners use ethanol instead of MTBE (the additive used in most other RFG areas to meet the oxygen requirements of the RFG programs). This means that RFG from the rest of the country cannot be shipped to the Midwest if additional supplies are needed. Refiners must ship a special blend stock used to make RFG in the Midwest, called RBOB, which is very difficult to manufacture. Let me tell you what happened at CITGO's Lemont, Illinois, refinery—one of the six refineries in the area. During the first two months of this year, our refinery produced more RFG than in 1999. But as we began making the new Phase II RBOB, which was mandated by EPA regulations, we quickly fell behind last year's production because it was more difficult to blend than we had anticipated. It has taken until June for us to learn how to efficiently blend this product and catch up with last year's RBOB production levels.
- **Low inventories.** According to the Department of Energy's. Energy Information Agency (EIA), crude oil and gasoline inventories started the summer driving season at extremely low levels. These lower inventories are the result of converting to EPA's Phase II RFG "summer" specifications. To convert to the tighter specifications of the new summer grade RFG II, refiners, as well as terminals, virtually empty their storage tanks to minimize the time required to convert the tanks to be ready for the summer driving season. In their website, EIA states that there is the equivalent of only two days' of consumption in available inventory. When supplies are this low, any disruption results in price increases.
- **Operational problems.** Two pipelines serving the upper Midwest have experienced operational problems, at the time when refinery and terminal inventories were low. This prevented these low inventories from being replenished. As stated in DOE's just issued "*Primer on Gasoline Pricing*," disruptions such as these

<sup>2</sup> CERA Special Report—*Gasoline and the American People*, May, 2000

<sup>3</sup> Congressional Research Service—*Midwest Gasoline Prices*, June 16, 2000

in a tight regional market have the potential to lead to significant price increase—as evidenced in the upper Midwest in recent weeks. This was further exacerbated when the Mobil Joliet refinery was slow coming up after a turnaround, and the Clark Blue Island Refinery experienced a power outage that has left it essentially inoperable. Both these refinery outages reduced the availability of gasoline in the Midwest. Finally, just this month, the ship channel through which we receive crude oil and ship out finished products at our Lake Charles refinery was blocked because of a freak accident disrupting our ability to ship products to all markets.

- **Patented RFG Process.** A recent federal court ruling that Unocal has a valid patent on a blend formulation related to the new summer RFG has caused RFG production to be scaled back at several refiners. For instance, CITGO's Lake Charles refinery has the ability to produce about 15,000 barrels per day of summer grade RFG, but to avoid the patent issue, we have cut production to about 4,000 barrels per day.

The Congressional Research Service memorandum concludes that about “25 cents of the regional price increase is due to transportation difficulties and another 25 cents, roughly estimated, could be due to the unique RFG situation in Chicago/Milwaukee.”

The inescapable fact is that the U.S. pipeline and distribution system was designed to handle a half dozen grades of gasoline. Today, it has to cope with more than 3 dozen grades of “boutique” gasoline. Keep in mind that no refinery can manufacture all of these fuels, so they have to be shipped all over the country to where they are needed. Each of these fuels has to be kept separate from the time they are manufactured—separate pipeline shipments, separate tankage, separate compartments on barges and trucks. Daniel Yergen has rightly called this the Balkanization of America. Our nation can no longer substitute fuels from areas of abundant supply into areas of insufficient supply because they are literally different fuels. A patchwork of fuels mandated by different state regulators has unintentionally constrained manufacturers' ability to refine and supply gasoline to the marketplace. [See attachment #1]

Let's look specifically at the Midwest. PADD II, which includes the Chicago and Milwaukee markets, is a net consumer of gasoline. In 1998, for instance, PADD II consumed almost 475,000 barrels per day more gasoline than the refineries in that area could manufacture. According to the just-released National Petroleum Council's report, in order to have supply meet the demand in PADD II, 350,000 barrels per day had to be shipped in from the Gulf Coast, primarily by pipeline, and another 160,000 barrels per day had to be shipped in from the East Coast. It is clear to see that a supply problem in the Midwest, the Gulf Coast or the East Coast has a definite impact as product is pulled from one region to fill shortages in another.

In my hometown of Tulsa, we are experiencing a situation that graphically illustrates this point. Like many other regions, Tulsa has experienced in recent weeks sharp increases in gasoline prices. Here's why: our local regulators have entered into an agreement with EPA so that a special gasoline with 8.2 Reid Vapor Pressure (RVP) is sold in Tulsa county during summer months. Tulsa is the only area in the nation where this particular gasoline is sold. As a result, no refiner manufactures it, but rather two different gasolines are mixed together to meet the 8.2 specification. Most of these two kinds of gasoline come from refineries on the Gulf Coast and are transported by pipeline to Tulsa. That was not a problem in 1999. Unfortunately, since last year, 98 counties in East Texas that are along the pipeline that connects Tulsa to the Gulf Coast refineries now require one of the gasolines that is blended to make Tulsa's fuel. That increased demand from motorists in the Texas counties caused an increase in the price of gasoline in our Tulsa market when the summer driving season began. Once again, this is a simple case of the relationship of supply, demand and price.

This is a recurring theme around our country. As local regulators create new and different gasolines, refiners no longer have the flexibility to quickly shift supply to the areas of greatest need. The result is that situations that previously could have been corrected very quickly, take much longer for the system to correct. This longer correction time creates shortages, which in turn creates price spikes. The delicate balance of the supply and demand system can be upset by the slightest disruption.

This price and supply situation is not the first such occurrence in this nation, nor, unfortunately, will it be the last unless industry warnings are heeded. Similar situations arose in 1989 with the advent of EPA's regional RVP regulations, again in 1995 when Phase I RFG was introduced and again in 1999. According to industry expert Trilby Lundberg,<sup>4</sup> despite persistent industry warnings, “We are in a night-

<sup>4</sup>The Lundberg Letter—*Distribution Crisis Hits the Midwest*, June 22, 2000

mare of patchwork environmental regulations which will wreak havoc with gasoline supply and price stability. The wide variety of regulations affecting formulas has created wide price disparities around the country and made the distribution of gasoline more problematic.”

The important point to recognize is that the root cause of the current price and supply situation stems from the unfortunate fact that this nation’s only energy policy is driven by the Environmental Protection Agency. In reality, it’s not a policy at all but a patchwork quilt of regulations and requirements that has been added to every year since the Clean Air Act was passed in 1970.

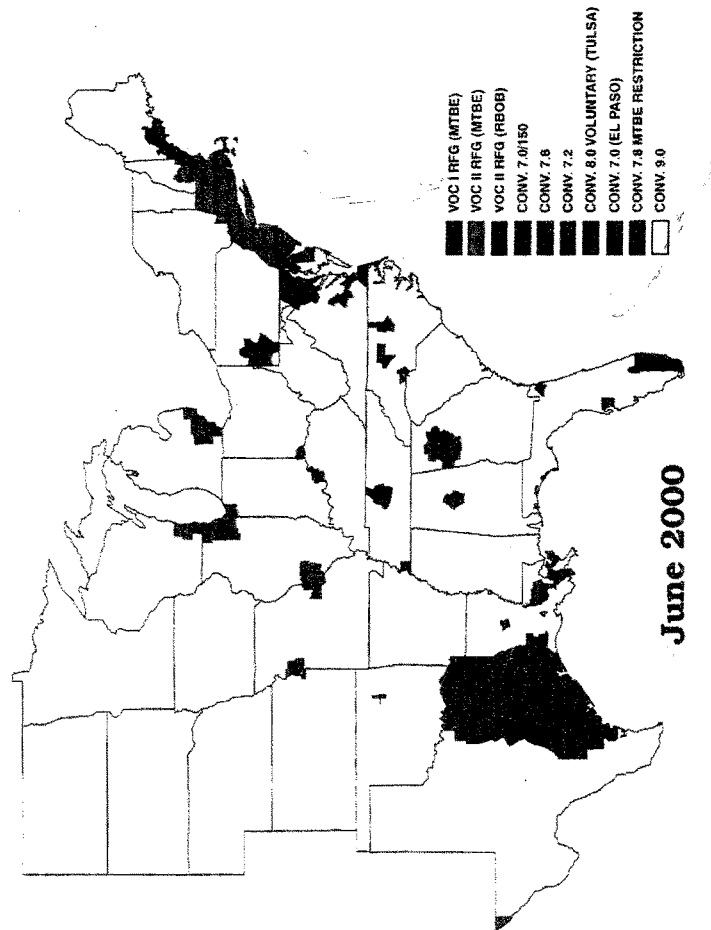
This hodge podge of regulations fails to take into consideration the American people’s needs or the refiners’ ability to produce and distribute this increasingly complex range of products. It’s a refiner’s nightmare—one that is now beginning to affect the American people.

And it appears there is no end in sight. We are already faced with the next wave—EPA’s requirements for ultra-low sulfur gasoline and diesel specifications. The end result of these and the host of other EPA regulations staring us in the face ensure that more refiners, unable to afford the capital investment required to comply with these regulations, will drop out, further tightening supply. Clearly, unless we develop a cohesive energy policy—one that considers this nation’s energy needs, the sustainability of affordable energy in America is in serious jeopardy.

Thank you.



# Current Summer Gasoline Requirements



Mr. TAUZIN. Thank you, Mr. Thompson.

Mr. Ports, unfortunately we have seen a lot of finger-pointing about the Strategic Petroleum Reserve; and we have reauthorized the Strategic Petroleum Reserve twice, and there have been three sales from that reserve in this administration, and we have also sold Elk Hills, which was a National Security Naval Reserve. It has been sold to the private sector, so we probably have less security in those reserves than we did just 7 years ago.

But putting all of that aside, Mr. Ports, you make the case that it is time to have a thoughtful discussion about the real causes of these price increases, understanding them, we can start making recommendations.

And, Mr. Frank, you pointed out what we might use in terms in making policy.

Mr. Thompson, you point out correctly—and I think Mr. Largent pointed out earlier, when the EPA director was here—that so much of the policy on gasoline that is critical to consumers in the marketplace is now determined by EPA in direct rulemaking on reformulated gasoline or in the obvious pressure that comes from communities that are out of compliance with Clean Air and have to adopt their own special “boutique” gasolines to meet the standards of attainment of Clean Air as they currently exist, not even considering the new ones EPA tried to impose and the courts said were unconstitutional.

But the biggest problem that I see—and I am trying to put together all of your testimony and there are an awful series of events.

Two pipelines crashing, weakening the delivery of material to the Midwest, a continued operation at 20 percent pressure down. If you simply were able to bring them back to normal operation, you could certainly deliver more product to the Midwest.

The Mobil Joliet refinery, slow to turn around and the Clark Blue Island suffering power outages, and the Lake Charles refinery, blockage in the port.

EPA granting waivers to St. Louis—why they got three waivers, I don’t know—and all of a sudden, products get shifted over to St. Louis that might otherwise have ended up at Chicago or Milwaukee.

We are seeing literally, as indeed you pointed out, Mr. Thompson, so accurately, the balkanization of the American energy supplies. Daniel Yergin wrote “The Prize”; it is probably the best explanation of the history of the oil and gas industry that I have ever read. We had him as a guest of our committee, and I had a chance to meet him.

What he is telling us is that if we continue this process of mandating “boutique” content for gasoline in each of the communities of America to meet EPA standards, to meet the local community standards, to achieve EPA air quality attainment, if we continue this process, we will all be like California where the shortest disruption in refining capacity, the shortest disruption in delivery systems, will automatically spike prices up. And I saw from a number of your testimonies, we are going to go through this one with a lot of blame and finger-pointing, and we are going to conclude that we have a problem on our hands, this lack of one area to supply an-

other area because it doesn't have the same gasolines and the same requirements.

We are all going to be like California. This is going to get repeated again and again, not just this summer but over and over again. We are not only going to have shortages in the gasoline market, but as the energy needs of the e-commerce society continue to grow despite our best efforts at conservation and alternative fuels, we are going to see more and more blackouts, brownouts and price spikes on consumers regionally generated, not because we don't have enough crude or gasoline, but because our refining capacity can't keep up with all of these little markets that require separate tanks and pipelines and separate trucks and separate market, if you will, conditions, all of which can cause us to become little Californias, all subject any day to having price spikes that all of us are going to have to explain to our constituents.

Have I described the world as it really is?

Mr. Frank.

Mr. FRANK. Yes, sir, I think your explanation this morning and here this afternoon describes the situation very accurately. Whereas PADD II, if we looked at it as a discrete source, instead of being one homogenous tank of supply of gasoline into the Midwest, when one area was experiencing a shortage, it could flow from another area. Because of the patchwork nature of "boutique" fuels to be supplied to separate markets, each one has to stand on its own two feet, much as was described by Congressman Largent this morning; and it has to have its own inventory and its own supply, and it is more prone to disruptions, as any kind of infrastructure problem relates.

Mr. PORTS. I would say that we are definitely there. We are similar to California throughout the United States on gasoline, but we have a chance to save diesel fuel. The EPA has proposed regulations that, frankly, will potentially carve up the diesel fuel market in a similar manner, maybe not as dramatic. But the fear is that we can go through the same thing on that side.

Mr. TAUZIN. Mr. Luther is recognized for 5 minutes.

Mr. LUTHER. Thank you. I appreciate this opportunity.

I know all of you were present this morning when we had the administration officials testifying, and my recollection is that they indicated that the pipeline situation would have had minimal impact on the current situation; and second, I think, if I recall the testimony correctly, there was testimony that the Phase II program could have very little impact.

In addition to that, let me just say, as I understand it, Minnesota, the State that I represent, is not subject to the Phase II program.

So my question to each of you would be, first of all, what is the most concrete answer to the geographical differences?

Second, why there would be a reduction a day or two after the FTC announces an investigation, a price lowering?

Third, why the retail prices don't follow the reduced wholesale prices?

Mr. FRANK. The Secretary of Transportation said that the impact of Explorer was only minimal and that the volume of gasoline his-



torically shipped to the Chicago market was essentially the same as what it has been in the past. That, in fact, is true.

The rest of the story is that that pipeline capacity has been reduced from 540,000 to 490,000 barrels a day. The same amount is going to Chicago. The rest of it was basically dropped off into another pipeline, the Williams pipeline that goes to Minnesota, and that pipeline system is running 50,000 barrels a day short of supply, and that is why I think you have seen the price response in the Twin City area, just like in Chicago. The whole thing is trying to compensate itself as people are hauling product to try to satisfy demand, but the pipeline system has caused a shortage of gasoline into PADD II.

The Chicago market is getting what it normally required on a historic basis, but the inventories were depleted to very low levels. And I would like to show you an exhibit here what happened when the waiver was initialed in the St. Louis area, that the inventories in PADD II immediately started falling. And then they built slightly and started falling again, and only recently, in the last 3 weeks, have they started building; and the numbers that were available just last night, which are shown on the far right-hand side, have shown a significant build in PADD II.

The way I would describe that is, the free market is working. Demand has decreased our sales in PADD II; people have quit driving as much as they were previously, and inventories are starting to build back up to a more stable condition. But the Minneapolis area, St. Paul, the Twin Cities, suffered by the fact that Explorer was down. And that is where the shortage was showing, and Chicago was not able to replenish their gasoline supplies. They were receiving just historic demand levels until consumption dropped, and that is why we started seeing the build.

Mr. LUTHER. Then, if you can, comment on the second and third points as well.

Mr. FRANK. That is the investigation and the price decline, and another graph here that we have shows that—remember the inventories reached their low point on June 2 and started building again.

Here shows when the waivers were announced and what the price response was and when the inventories started to build.

On June 7, after the inventories were showing a build, prices started down right then. The Administrator of the EPA and the Chairman of the FTC had announced the investigation at that time. There were calls for investigations all of the way up that price ramp, but the market was ignoring them and reacting to the free market system; and the prices continued to rise to allocate supply and demand together.

The prices started down on June 7; this is public information. And then when the Blue Island Refinery that Congressman Tauzin referenced had a fire on a Thursday, and they announced that they had the fire, the spot market went up 10 cents a gallon that night.

Mr. TAUZIN. The gentleman had a third question, if you would respond.

Mr. FRANK. The answer to the third question is that prices always lag at the street in an up-rising market; as independent businessmen operating service stations are trying not to lose market share, the price goes up; and if they raise the price, they are not

selling as much, so the street price lags going up and it also lags coming down. When it is lagging coming down they are trying to recover what they lost when it was going up, and that is a general explanation of why street prices respond as they do.

Spot prices react immediately. They are simultaneous, rack prices of suppliers react almost that quick, but the street price lags. Even though prices were quoted this morning as not being down very much in various areas, in the Chicago market, for instance, a survey of street price that is we take every day shows that street prices are down 20 cents a gallon, not 3 to 4 or the 40 cents that was quoted.

They are coming down, the free market is working, and they will continue to follow free market prices as they correct to supply and demand.

Polls are really popular. I know here everybody likes to look at polls. Our customers vote every day, and we are able to take a poll every day. They vote with their tires. If we are in the right price perspective with our products, people are not buying.

Mr. LUTHER. If I could just mention, to find a better price in the Twin Cities area, they would have worn the tires off their car looking. So it doesn't always work that way. In a perfect situation, that is the way it is supposed to work.

Mr. THOMPSON. Very quickly to respond to your first question, what we had was a confluence of three events that, any one taken in isolation would not have the dramatic impact that we experienced, but those three experiences were the pipeline outages that we talked about that occurred at the same time that we had inventories at historic low levels as we were converting from winter grade gasoline to summer grade; and this applies to conventional gasoline as well as RFG. So inventories of all gasoline were low at the time we had the outages.

That came on top of a requirement for refiners to blend a gasoline that we had never blended before, and we had a learning curve that we had to come up to to learn how to efficiently blend this gasoline. In the early stages, we had to do a lot of touch-up blending that kept supplies off the market, because we cannot ship product that is off specification.

So it was a confluence of these three events that caused the dramatic price increases; any one in isolation would not have had the effect that we saw.

Mr. TAUZIN. Mr. Oxley.

Mr. OXLEY. Thank you, Mr. Chairman. I wish I could go back and get some of the headlines when we had the oil embargo and some of the other price spikes. Senator Metzenbaum would always come out and say, this was a part of the oil companies and they were all colluding; and then they would have an investigation by the Justice Department and the FBI. And at the end of the day, everybody found out there was no collusion, this was supply and demand, this is how markets work—surprise, surprise—and then you would have another spike, and we would go through the same drill.

It is Groundhog Day. Mr. Gore's spokesman, he is convinced that the oil companies are, quote, "in large part responsible for the price of gasoline." I guess he means the recent high price. I wonder if

they were responsible for the low price of gasoline a few months ago.

Mr. FRANK. The price of crude oil has gone up 300 percent, from \$10 a barrel to \$30 a barrel, and to cope with that in any kind of retail market is extremely difficult. And I would suggest that when the price would move from 80 to 90 cents a gallon last year, people were complaining about the high prices.

And given no other shortage, in a normal operating environment, if they were 50 cents higher, which is what \$20 a barrel equates to, I would submit that we would be here at this hearing today, and FTC would be having an investigation, and nobody would understand why the prices went up.

I think the American society has gotten to where we expect low energy prices, "I think my electric bill is too high and my natural gas is too high and gasoline bill is too high."

The real problem is that this business has earned in the past 10 years—and it is the same for 20 years—a 5 percent return on capital employed. The Standard & Poor's 500 has earned 17 percent. The cost of capital is 10 percent. With the cost of capital at 10 percent and earning 5 percent, that means we are really liquidating the downstream business in the United States. And if you ask me, what would I invest in today, should I invest in a downstream company, you would be better advised to buy a CD from your local bank because your return would be higher.

This cannot go on, Congressman. You are seeing public statements by large refiners and marketers that they are exiting this business, they are moving on.

Mr. OXLEY. I have always thought we get telephone calls from constituents, basically, "the price of gas is too high," or accusing the oil companies of gouging.

There is a quote from Vice President Gore calling for a Federal Trade Commission investigation, "Put our feet on the brakes of big oil's price gouging." This is from a Wall Street Journal op-ed piece by Steven Lansburg, professor at the University of Rochester. In other words, he says, it is fine for big powerful entities to set prices by fiat ignoring supply and demand as long as those entities have names that begin with Federal.

And again, I think it does point out the difference in supply and demand in the free market versus those who would try to socially engineer through various commissions and government entities, and I find it rather interesting that we come around this every several years and have the same old argument.

My guess is, if we have this hearing—as a matter of fact, we would not have this hearing 4 weeks from now because of what you say, if supply is starting to come into line with demand, there is no need and this will all be a bad memory for all of us.

My concern is that we will forget about the short-term problem and ignore the real long-term policy of having an energy policy of this country that basically says we can be fat, dumb and happy with low energy prices, but we are not willing to make the commitment to finding more domestic sources of oil. And I find that tragic, and my guess is, until the public really understands that, we are going to be in the same mess some time in the future; and we will have the same arguments and the same hearings and the same fin-

ger-pointing, but it doesn't direct itself to the long-term solution. And in the meantime, we continue to increase our dependence on foreign oil.

What a shame, and shame on us.

Mr. FRANK. That is exactly right. The way I view it, this entire country, across all sectors of energy, is crying out for a national energy policy that will enable them to be able to survive as we go forward; at the kind of returns that I am talking about, the downstream business will not attract the investments necessary to be able to provide the energy needs of the country.

Mr. TAUZIN. Mr. Barrett.

Mr. BARRETT. I do represent Wisconsin, and the motorists in Wisconsin feel like they are being gouged. There is no doubt in their mind that they believe they are being gouged. I agree with them.

Today, I hear the talk, it is the "boutique" gases. Well, in southeastern Wisconsin, we replaced RFG 1 with RFG 2, not exactly a proliferation of gases.

I hear talk about the Unocal decision. The Unocal decision applies to all reformulated gas, but the spike has occurred in the ethanol-based regions. Why on ethanol but not MTBE-based gasoline?

I hear people saying that we have to have a national policy, government has to work with industry. That is exactly what was attempted in the meetings that were held over the last 3 years—four meetings a year with industry representatives, the EPA, to have a smooth transition to the RFG 2 program.

I have gone through the minutes of these meetings, and never in these meetings did I see a single reference by any member of the industry to supply problems. Now, I look at that and I am thinking, if there are supply problems, why aren't we going to know that before this program takes off? And, instead, what I see is a statement from Tosco in April of this year, "Low inventory levels will result in a continuation of strong refining margins."

You knew there was a shortage, but you didn't tell the EPA. So who gets gouged?

Mr. FRANK. This battle was fought back in the 1990 Clean Air Act days, and I was a part of that. I have been here for a long time. I testified before the EPA in public hearings that there could be supply disruptions, that there could be people who elect not to make these gasolines because of the investments necessary. I made those statements, and in meetings with the EPA and the Department of Energy; and I have continued to make those kinds of statements.

Mr. BARRETT. I have gone through the minutes, and I don't see a single representative saying that. If there was a supply problem, why wasn't that brought to the attention of the EPA? Either someone was asleep at the switch or someone is pulling a fast one. But what strikes me is, we have a situation where I will predict that each of your companies will have record profits this year.

Mr. FRANK. That may well be true.

Mr. BARRETT. The people in my neck of the woods feel like they are being gouged.

Mr. FRANK. My company has produced 18 percent more reformulated gasoline than last year, and we put 18 percent more into the

“boutique” fuels; and some of it comes from efficiencies in processing, and some comes because our production of conventional gasoline is down, and the production of “boutique” fuels, reformulated gasolines, is up.

Mr. BARRETT. Mr. Pillari, the spread in Milwaukee between the wholesale price and retail price is 67 cents. Back on June 9 it was 38 cents. Will we see a decrease in the spread, and what will it be when the market settles out?

Mr. PILLARI. I would not like to forecast what prices will be.

Mr. BARRETT. What is the industry average difference between the wholesale and retail price?

Mr. PILLARI. Let me go back to where we have been. In the past, I think you would have seen the spreads between those fuels to be anywhere from 2 cents to 10 cents a gallon depending on the supply/demand situation.

Mr. BARRETT. Between wholesale and retail?

Mr. PILLARI. Sorry, I wouldn't want to predict what it will be.

Mr. FRANK. In the Milwaukee area—from the information I have available through the day before yesterday, in Milwaukee the wholesale price is—

Mr. BARRETT. My question is, in the industry, what is the expected, normal differential between wholesale price and retail price? It can't be a difficult question.

Mr. Thompson?

Mr. FRANK. We have a higher expectation than what it has run, that gets us to at least recovering our cost of capital.

Mr. TAUZIN. Mr. Thompson, would you attempt to answer? The gentleman's time has expired.

Mr. THOMPSON. You have to look at that on a before-tax basis because each tax situation, State-by-State, location-by-location, is different so you have to look at it on a before-tax basis. Typically, the before-tax price between a wholesale price terminal at the truck rack and that pretax price that the dealer will charge at the street is typically 12 cents a gallon.

Mr. BARRETT. Between wholesale and retail, and we are seeing 67 cents right now?

Mr. THOMPSON. Yes. And as Mr. Frank pointed out, the majority of the service stations in this country today are owned and operated by independent businessmen who make their own pricing decisions based on competitive factors in their marketplace.

Mr. BARRETT. Your company is vertically integrated.

Mr. THOMPSON. We have over 14,000 service stations in the United States that carry the CITGO flag. Those are all owned and operated by independent businessmen who have their own freedom of choice over pricing, and they use that freedom to set prices on a competitive basis based on their local marketplace.

Mr. TAUZIN. The gentleman's time has expired.

Mr. BARRETT. Mr. Chairman, I honestly thought that was a pretty easy question; and I am disappointed that I couldn't get an answer about the average spread between wholesale and retail prices. I thought someone in the industry would know that.

Mr. TAUZIN. The Chair would, for the sake of the gentleman, refer to the EIA reports which are available to the committee, which does show the spread.

Mr. BARRETT. I have the spread. I would think that there would be an industry norm of what the differential is between the wholesale and retail price. None of the representatives could give me an answer to that.

Mr. TAUZIN. There was testimony in the record that the prices, the spreads between what independent businessmen pay and what they charge at retail is set in the marketplace. The gentleman got an answer.

Mr. BARRETT. No, I didn't get an answer. If it was set in the market, they would have what the average was.

Mr. TAUZIN. The Chair has to control the time.

The Chair recognizes the gentleman from Texas, Mr. Barton, chairman of the Subcommittee on Energy for his 5 minutes.

Mr. BARTON. I think Mr. Barrett has a very valid point. It looks like the spread is what the market will bear, and his constituents are suffering for it.

Could we put the chart back up that shows the Chicago market wholesale gasoline prices just for a second?

Now, if this were a political problem that could be solved politically, I would look at that chart, and I would look at the blue line and the black line and the red line at the bottom, and I would say, Congressman Tauzin and Congressman Bilirakis and Senator Lott just do a lot better job politically than the Congressmen and Senators in the Chicago market, and all we have to do to do is send Tauzin and Bilirakis and Senator Lott to Chicago.

Mr. UPTON. And do you send an interpreter, too?

Mr. BARTON. It is not a political problem, it is a market problem.

I would like to go back. We produce about 73 quads of energy in this country, and a quad is 1,000 trillion BTUs, and a BTU is the amount of energy it takes to raise a gallon of water 1 degree Fahrenheit. So we are producing about 73 quads and we are consuming about 97 quads, and that shortfall is coming in from overseas; and until we take steps to minimize that shortfall, the price mechanism in an open market is going to go up when there is higher demand. It is that simple.

But with this group, I want to focus on the specific problem—and Mr. Barrett has talked about it, and it is one of the focuses of the hearing—and that is why prices are higher in some parts of the country than other parts of the country and, specifically, up in the Chicago and Milwaukee area.

I am going to read from the committee brief and then I am going to ask if you gentlemen agree or disagree. It says, "RFG is a smaller percentage of the regional gasoline supply in the mid continent than in most other regions. Essentially it is used only in Chicago and Milwaukee"—and there is a chart which shows that—"the rest of the regions use conventional fuel.

"Those cities have virtually banned MTBE from RFGs sold in their cities. Instead, ethanol is used to increase the oxygen content of RFG to minimize carbon monoxide emissions. In current market conditions, the price of the gasoline-based material need for oxygen blending, called RBOB, rather than the cost of ethanol has become the primary factor in the region's high prices.

"The difficulty stems from the fact that RFG volatility, the speed of evaporation, is limited by regulation. Ethanol is much more vola-

tile. In order for the ethanol blend RFG to fall under the overall volatility limit, the volatility of the RBOB to be used in ethanol blending must be low. This is a matter of blending volatile ethanol, a physical fact that cannot be changed, with special reduced-volatility RBOB.

"The difficulty arises because low-volatility RBOB is hard to manufacture and there is very little demand for this material outside the Chicago-Milwaukee gasoline market. Most of the required material is made in six refineries in Illinois whose total capacity is approximately 1 million barrels a day. When demand exceeds local refiner's ability to manufacture the low-volatility RBOB, supplies are brought in from the Gulf Coast by pipeline.

"Low-volatility RBOB is a specialty product. Not all refiners can or will manufacture gasoline to such specifications. Shipping presents difficulties stemming from the unique nature of the product. It is usually shipped in relatively small quantities. Additionally, transportation bottlenecks affect the price and availability."

Do you agree or disagree with that?

Mr. FRANK. I think I agree with that. The basics are that the RBOB has to have a Reid vapor pressure of 5.8 pounds.

Mr. BARTON. That is by Federal law.

Mr. FRANK. That is lower than what you blend with MTBE, which is a low vapor pressure blend stock—

Mr. BARTON. So we have a specialty product.

Mr. FRANK. So you have to refine to get the petroleum component of the RBOB to a much more sophisticated or stringent level to be able to accommodate putting the ethanol with it.

Mr. BARTON. If you will prepare answers for the written record, I would appreciate it. If this committee can segregate the problem to a political solution, we will apply a political solution; but I am going to be very surprised if we find a political solution. It is a long-term strategy of energy production and conservation that we have worked on together over time, that includes the environmental issues that drive our energy policy in this country.

Mr. TAUZIN. The gentleman's time has expired.

Mr. PILLARI. I think you are correct in that making RBOB does require much lower RVP. We invested over the last 2 years in a refining complex prepared to make it.

Mr. NEMTZOW. There may be a policy solution that is different from a political solution or a market solution.

Mr. MARK BROWN. I think the people of Milwaukee will have a difficult time with some of the explanations. We have a distribution problem and a supply and demand problem and predatory pricing somewhere in the food chain.

Mr. TAUZIN. The gentleman's time has expired.

The gentlewoman from Missouri, Ms. McCarthy, is recognized.

Ms. MCCARTHY. I wish that more of our Midwest delegates were here to engage today. We have competing interests with serious health care issues on the floor, and I know that many other members would like to be here to participate in this important discussion. Please understand that we at least have gotten some semblance of order on the floor now.

I wanted to ask three panelists in particular to comment, but anyone may weigh in.

Mr. Gerken, I want to thank you for the realistic assessment on the reliability problems that we have in electricity delivery. This is the committee that is grappling with deregulation, and I wonder if you can expand upon your assertions with regard to the reliability problems in electricity and that they may very well be traceable to market manipulation.

If you can give the committee some examples, I think that would be helpful.

Mr. Nemtzw, I want to commend you for speaking very realistically about the fact that there is plenty of opportunity to go around here. I have been grappling with this issue since the 1970's, and there seems to be a reluctance to increase the R&D spending and provide the tax credits to encourage alternatives and invest in renewables and efficiency programs and help power plants to modernize; and I wondered if we could expand on, just realistically, what this current Congress should be doing.

Mr. Pillari, why are some oil companies like BP so ahead of the curve and embracing opportunity, diversifying and creating a win-win solution for the environment and the economy? You see the future and your company embraces it, and how can we get other companies to do the same?

Thank you.

Mr. GERKEN. I will go first. One of the things that we think, and Secretary Richardson said today, we support it, a comprehensive bill. Stand-alone reliability will not get this done. FERC Order 2000 was a pretty decent order, but the problem was that it allowed voluntarism on the creation of RTOs; and in layman's terms, that is just a bigger area that controls transmission. And it is supposed to be an independent operation because right now the majority of the generating companies own the majority of the transmission system.

The manipulation is allowed to occur because the people that are setting the capacity calculations on an hour-to-hour, day-to-day, month-to-month basis are those same people, the owners. Just like I gave you the illustration of the highway. At any time during the day, based on weather or an outage or capacity reserves, in essence, if there is zero capacity from one interface to the other, what probably is occurring is the incumbent transmission owner, who also owns generation, is setting a huge margin to back up maybe 100 percent of his generation in case one of his plants goes down; which means there may be a lot of capacity available in a true sense, but they are holding it back from anybody's use because they want to reserve it for themselves.

As an organization, our members have invested \$150 million in hydro renewable resources at above-market prices. We have invested in load management systems to shed load, to defer the off peaks of air conditioning and hot water heaters to non-peak times.

I support my colleague on the left on energy conservation, but the real crux is, FERC has the ability to establish the RTOs. The voluntarism is not working. I have attended the RTO workshops put on by FERC. It is not getting done, and I think they have to move, and Congress needs to push that along—they have the tools to do it—and a comprehensive bill will follow, and it will work.



Mr. NEMTZOW. At the rate our Nation's energy situation is going, it won't be only members from the Midwest who are here with troubled constituents, you said, realistically, before this Congress.

So let me give you six suggestions that I think pass the realistic test for this Congress. No. 1 is to hold hearings, not only ones like this on the big picture, but specific ones. Why does the Federal Government waste \$1 out of \$4, wasting \$2 billion a year? That is the subject of oversight hearings that this committee does so well.

No. 2, research and development spending. The House of Representatives voted, in what I would call an astonishing vote, 214 to 211, to kill the PNGV, automakers working with the National Labs. You need to reverse that.

Three, deployment programs such as the Energy Star program and programs that help educate. Those need full funding.

No. 4, push the administration on their 8-year-late air conditioning rulemaking and liberate them from the rider on CAFE that prevents them from even thinking about fuel economy standards.

No. 5, the Public Benefit Fund which should be part of any comprehensive restructuring legislation. This fund will help consumers meet their electricity needs and will help utility companies have funds for reliability investment.

Six, the bill introduced by Congressman Matsui and Congressman Thomas on tax credits. You have a giant surplus. Tax credits to promote energy efficiency goals will help the Nation's energy posture, will help taxpayers have lower tax bills and will be wildly popular.

That is my list of six. I have a hundred more.

Mr. PILLARI. Congresswoman, thank you for your comments. I would raise just two points on why we take the positions we do on clean fuels and climate changes.

One, we think that we have an obligation to provide our customers with products that don't do harm to air, water or humans. We think that is the kind of company that we would like to have.

Second, it is good business. We believe, in the long run, that customers will prefer environmentally clean and safe products. It is not easy to do everywhere. We try to do it where we can, and I am not sure that I want to convince my competitors to do the same thing, because it may be an advantage as we go forward.

Ms. MCCARTHY. Thank you, gentlemen.

Mr. UPTON. The Chair recognizes Mr. Shimkus.

Mr. SHIMKUS. Mr. Thompson, I fill up at a lot of your stations in southwestern Illinois and I appreciate the ethanol mix you provide.

Chicago price spikes, there has been debate between industry and the administration. The State of Illinois submitted a request to get relief from Phase II in November 1999. Had the administration acted on that, as they did in Missouri, how would that have affected the supply problem in Chicago? In your verbal testimony, you mentioned the increased time effort, energy, of doing the formula for Phase II.

Mr. THOMPSON. I think a waiver may have had a dampening effect on the severity of the price shortage, but again, as I said earlier, it was the confluence of really three events which caused the very severe shortage.

Mr. SHIMKUS. I also want to mention two other things. First, a question.

I know Williams Energy will be sending a letter to USDA saying that they can transport ethanol via pipeline. I would ask the three oil industry representatives here, do you believe that?

Second, do you believe—is it a fact that currently, in Brazil, ethanol is being shipped over the pipeline today?

Mr. Frank.

Mr. FRANK. Ethanol cannot be shipped through the normal logistical pipelines.

Mr. SHIMKUS. So you are saying that they do not ship ethanol via the pipeline?

Mr. FRANK. I don't know about Brazil—

Mr. SHIMKUS. If Williams does make the statement, you would dispute that?

Mr. FRANK. Ethanol is a solvent. It picks up water, condensation and rust.

Mr. SHIMKUS. Mr. Pillari?

Mr. PILLARI. I have not seen the Williams proposal. We have not seen any evidence. For the reasons that Mr. Frank mentioned, I don't know what is happening in Brazil.

Mr. SHIMKUS. Mr. Thompson?

Mr. THOMPSON. I believe Brazil is shipping ethanol by pipeline. The National Petroleum Council study released last week looked into that issue. The conclusion was, that system would not work in the U.S. pipeline system. I am not sure whether Williams will be successful or not.

Mr. SHIMKUS. Thank you. I appreciate the short comments.

Two other comments I want to bring up in my time. First of all, we have not talked much about diesel, although Congresswoman McCarthy, I am a promoter of biodiesel, and this is just an appeal to the industry. There are folks out there that would never want to see another diesel engine or diesel fuel used in this country.

I would also turn your attention to the recently released report required, under section 211(b) of the Clean Air Act. I think for the industry—for my soybean growers, I think a good marriage can occur that helps decrease reliance on foreign oil and helps increase commodity costs. And I would encourage you to look in those directions. And I know many of you are, but this study, I think, is going to be very helpful in doing that.

Finally, Mr. Chairman, I ask unanimous consent to submit for the record a release by the Renewable Fuels'—Eric Vaughn of the Renewable Fuels Association; he is testifying in another committee. I want to read one statement and ask the industry to respond to this. Basically, he goes through a calculation saying if wholesale is \$1.24 and 10 percent displacement, there is a possibility of a decrease in the cost per gallon. Does anyone want to comment on the Renewable Fuels position, how if you increase the volume of ethanol in the system that there could be a reduction? RE-85 pump sites in the Chicago area, which is 85 percent ethanol, average gas price is \$1.24 a gallon.

Mr. FRANK. I would say, sir, that the company that I am with is the largest user of ethanol in the United States. We consume 25 percent of the Nation's consumption, and the infrastructure that

exists today for the ethanol production, you have to spread it out to where it is available in regional markets, because it can't be shipped through these pipelines until you put in special alloy pipelines that don't have rust or scale or water in them.

It would have to be something like stainless steel. I think that ethanol can play a bigger role.

Mr. SHIMKUS. Thank you.

I yield back the balance of my time.

Mr. UPTON [presiding]. Thank you. I just want to say a number of things before, perhaps, we close.

First of all, I want to speak for the members that have not been here this morning and this afternoon. This is certainly an important topic, but as you may not know, we have an important piece of legislation on the floor, prescription drugs, and our committee is very involved in that debate and I know that a number of members on both sides of the aisle have been working that issue, and that is why we have had so many votes today.

I apologize for those members not here and I know that unanimous consent was made early on for opening statements and that will, in fact, be part of the record.

Mr. Nemtzw, I also want to congratulate you on a couple of your comments with regard to PNGV 2 weeks ago, but I have received some pretty good assurances that when that bill comes out of conference with the Senate that we will have adequate levels of funding, and those dollars will help build more fuel-efficient engines that will help all Americans, particularly with the struggling issue of fuel cost.

I would like to address my 5 minutes that I have to Mr. Frank, Mr. Pillari and Mr. Thompson. Maybe—if the chart with regard to the pipeline route might be put back up.

Ms. Browner from EPA, this morning she said that the Explorer pipeline has informed us that more RFG could be sent if the companies elected to do so? Is that correct? Are you not sending as much as you can at this point, based on the regulations that are out there with regard to the safety of the pipeline?

Mr. FRANK. I am sending as much as I can, sir. The pipeline carries conventional gasoline, "boutique" gasolines like Tulsa uses, the RFG gasoline. All of those are in there. If you didn't send diesel fuel, you could send more RFG.

Mr. UPTON. Then you would have a shortage of something else?

Mr. FRANK. Yes.

Mr. UPTON. Mr. Pillari, would you agree with that?

Mr. PILLARI. Yes, you can substitute. In our case, we have been able to meet the needs of RFG for our customers. We have done it through a number of routes, including a little bit on that one.

Mr. UPTON. Mr. Thompson?

Mr. THOMPSON. I agree with Mr. Frank's answer. The pipeline is operating at capacity.

Mr. UPTON. You don't have any unused capacity that is in there now? You are sending as much as you can in the allotments that you've chosen, based on the demand that you have got?

Mr. THOMPSON. Yes. And RFG would have to substitute for another product, which is also needed in those same marketplaces, so it would just shift the shortage.

Mr. UPTON. Prior to that statement that she indicated, she indicated this as well: The supply of RFG to the Midwest has increased this year over last year, and in fact, in the month of June, refiners expect to supply 650,000 more barrels of RFG this year than last year.

Does that jibe with what your companies know?

Mr. FRANK. I can't corroborate that statement. The real crux is what the RBOBs are doing, that is, what is shipped through the pipeline.

What is reported through the EIA as RFG gasoline is just a very small component that has already been blended with ethanol, and the supplies appear to be decreasing.

Mr. UPTON. One of you had a chart up there showing the supply of the inventories; it showed a decline, that chart here. As we try to get to the bottom of this, what I heard her say this morning, she is saying that we have a larger inventory this year than we had at the same time last year.

Do you agree with that or not?

Mr. FRANK. The supply in PADD II, I would say is definitely shorter.

Mr. UPTON. Based on that, you would think that is the case.

Mr. Pillari, do you think that is the case?

Mr. FRANK. Chicago would not have run out. It has to go somewhere, and Chicago is the only market other than St. Louis, which really doesn't use the same RFG that Chicago does. That is not happening in PADD II.

Mr. PILLARI. Production of RFG in our case is up. Total gasoline production is down, and demand is high.

Mr. UPTON. Would you say that you had a larger inventory starting in June, of RFG?

Mr. PILLARI. Our company had a smaller inventory than last year.

Mr. UPTON. Mr. Thompson?

Mr. THOMPSON. Yes, our inventories of RFG were down in the Chicago market.

What we have done, to try to bring more supply into the Chicago area, is barge gasoline blending components from our Gulf Coast refineries up the Mississippi River to this market, to bring more supply and avoid this pipeline constraint in bringing more supply up from the Gulf Coast.

Mr. UPTON. What percent of the supply of gasoline actually goes up the Mississippi in barges? Is there a lot?

Mr. FRANK. The biggest supplies are the Tepco pipeline and the Explorer pipeline. All of the barges that are available are running between the Gulf Coast, Louisiana, primarily and the upper Midwest. You cannot get additional barges. You cannot find trucks, they have all moved up to the Midwest and are being used to haul supplies from oversupplied areas to undersupplied areas.

Mr. UPTON. I know that my time is rapidly expiring.

Mr. Frank, are you aware of the letter that our Michigan attorney general sent to Ms. Mary Ellen Peters?

Mr. FRANK. I am very much aware of that.

Mr. UPTON. Mr. Pillari and Mr. Thompson, did your companies get—did you have an inquiry made by our attorney general in Michigan?

Mr. THOMPSON. I am not aware of one.

Mr. PILLARI. I am not aware of one.

Mr. UPTON. Mr. Frank, have you made any movement in terms of responding?

Mr. BARRETT. May I get a copy of that?

Mr. UPTON. Yes, I will be glad to make you a copy.

Mr. FRANK. This is a full-scale investigation of the same type that the FTC is going to conduct. We are cooperating with the Attorney General. Yesterday, we testified at a meeting similar to this in Michigan, with representatives, and explained the situation that we have.

Mr. UPTON. Was this in Lansing?

Mr. FRANK. That's correct. We explained the situation, that we had supplied 335 million gallons more into PADD II, and 241 million gallons of that went into the Michigan market to try to solve that problem. We were hauling gasoline by truck from Indianapolis to upper Michigan and trying to cope with that problem as other suppliers ran out.

At the end of the hearing yesterday, they were quite praiseworthy of the efforts that we had gone to in trying to keep Michigan supplied. The Attorney General wasn't a part of that, and the investigation is going to continue; and I think that that is just a waste of taxpayers' money. It certainly straps our resources to be going through a full-scale State investigation in three or four States, or five, and have a Federal one also.

Mr. UPTON. I would love to see when you officially respond to the attorney general if you might send us a copy. I will make it a part of our committee record as well.

I have one question with regard to Marathon's Niles' facility with regard to the transport of refined gasoline products. Niles is in my district, and I have been there a number of times. I am curious in terms of, I guess, the allegation or the charge that the attorney general makes with regard to fuel that was available to independent jobbers, and that perhaps—reading between the lines here, that perhaps Marathon was looking at helping their outlets, and the independent jobbers were excluded from participating, perhaps in conjunction with the broken pipeline.

I am more than amazed that the Secretary of Transportation indicated that it did not impact western Michigan which was, as far as I can see, never the case, it always impacted western Michigan, whether it be Niles, Kalamazoo.

If you would prepare a response regarding the impact on the independents—

Mr. FRANK. We have gasoline supplies for independent jobbers and our contract customers. We were contracted to have them selling Marathon products, and that is a contractual obligation. We meet those responsibilities first, but we always were able to direct the independent jobber where they could buy unbranded gasoline at various terminals; and quite frankly, the transportation resources necessary to keep Michigan supplied; that we could not satisfy on our own. All of the independent jobbers normally have

trucking resources of their own, and we were asking them to help out in the supply situation by moving to noncustomary supply points and hauling gasoline to places where it was needed.

Mr. UPTON. Thank you, and I will turn the gavel over to Chairman Tauzin.

Mr. TAUZIN [presiding]. Mr. Barrett is recognized for 5 minutes. Mr. BARRETT. At this point in the hearing, there is usually nobody left, and ordinarily I would have been one of those to leave, too; but as you may have inferred from my earlier questioning, this is a real issue for me and I frankly can't go home and say, well, I tried. I have to keep plugging away here and find out what we have to do to get these prices down in Milwaukee.

Earlier, I was asking about the differential between the wholesale price and the retail price, and maybe we can have a little primer here for me so I understand it.

Today, the wholesale price of gas in Milwaukee for RFG is a \$1.18. That is the price that the gas station pays for it, Mr. Frank?

Mr. FRANK. I'm sorry?

Mr. BARRETT. The wholesale price today, which is \$1.18 for reformulated gas, is that the price that the gas station pays your company for it?

Mr. FRANK. The wholesale price is not the same as the rack price. They normally track fairly closely, but they are not necessarily the same.

Mr. BARRETT. I might be missing something basic here. The wholesale price, we are talking about what the gas station pays for it, as opposed to what you pay for it.

Mr. FRANK. What I would call the "wholesale price" is what we sell to independent jobbers who don't use our brand.

Mr. BARRETT. So today the differential in Milwaukee is 67.15 cents between the wholesale price and the retail price.

Who is getting that money?

Mr. FRANK. If I am selling to an unbranded jobber, he is paying the price that I am charging for it, and he is selling at the street price, so that differential accrues to the independent businessman who is setting prices in the free market system.

Mr. BARRETT. So today the retailer is making 67 cents a gallon, as opposed to, on June 9, when he was making 38 cents a gallon?

Mr. FRANK. Three weeks ago, sir, he may have had a negative 20 cent margin.

Mr. BARRETT. And your company, though, keeps no records of an average, on an annual basis, an average between the wholesale price and the retail price?

Mr. FRANK. Yes, that is a matter of public information.

Mr. BARRETT. Again, I am just trying to figure out what a ballpark—

Mr. FRANK. I don't know what the average is, but it is readily available.

Mr. THOMPSON. Mr. Congressman, may I ask a question for clarification? When you quote your \$1.67, is that the price posted on the pump at the street?

Mr. BARRETT. What I am reading from is data provided by the Oil Price Information Systems. Wholesale prices exclude taxes.

Today, the wholesale price in Milwaukee is 1.18.88. The retail price, these are both for RFG, is \$1.86.03.

Mr. THOMPSON. Excluding tax, or including tax?

Mr. BARRETT. Excluding taxes. The wholesale tax, excluding taxes.

Mr. THOMPSON. Okay, that was my question. I wanted that clarification.

Mr. BARRETT. Let's just put you in my shoes now. Where do I put the pressure on to get that down?

Mr. FRANK. I would suggest that you let the free market work, and it will come into line with supply and sort itself out.

Mr. BARRETT. Let me ask you this then: Again, Mr. Thompson indicated, at least for Citgo in the eastern United States, I don't know what the situation is in the Midwest, there was an independent relationship, at least I inferred there was an independent relationship. With Marathon, what is the relationship between your company and the retailer? Are they independent or are they part of a vertical integrated system?

Mr. FRANK. We have some company-operated stations that are direct supply that are in the discounted—we call it value priced—end of the market that sell at relatively low prices.

Mr. BARRETT. Again, I just need a rough—percentage-wise, what percentage of your stations are independent; and what percentage have some sort of tie to you?

Mr. FRANK. Well, I would say that the Marathon brand stations, who are dealer and jobber operated, all have a tie to me as contract customers, and that, roughly, we would say that, on an annual basis, we sell about 40 percent of our volume to the independent classic trader.

Mr. BARRETT. And for BP Amoco, Mr. Pillari?

Mr. PILLARI. Roughly, because I am not that familiar with it—

Mr. BARRETT. I understand.

Mr. PILLARI. Roughly, we have around 60 to 65 branded outlets in that market, and about a dozen of them are outlets that we operate directly. So the rest of them would be full dealer.

Mr. BARRETT. Okay, in terms of the normal flow, how many days behind the wholesale market does the retail market respond?

Mr. FRANK. That is really sort of subjective. It depends on the amount of the decline. But I would say it would be around 2 weeks.

Mr. BARRETT. So would you expect—again, I am going to go home, and they are going to say, we have seen a 40 cent drop in the wholesale prices. When can we expect to see—

Mr. FRANK. You are misinterpreting my comment, I think, in that if the price fell a dime at the wholesale level today, roughly it takes 14 days to be translated to the street level. That may be plus or minus.

Mr. BARRETT. Okay. Again, so my question is, we have seen a 40 cent wholesale drop since June—

Mr. FRANK. It didn't all happen on 1 day.

Mr. BARRETT. I know, since June 16. So again inferring from your statement, I would think we would see in the next couple weeks a 40 cents drop in the retail—

Mr. FRANK. I don't know about those particular prices. I am telling you what we would normally see, historically. We haven't seen

price changes like this in modern history, of this magnitude. We didn't see them going up, we didn't see them coming down. The independent businessman never recovered his loss while that curve was going up, and he is trying to do some of that today.

Mr. BARRETT. Mr. Pillari, what do you expect to see?

Mr. PILLARI. Let me talk about two things. Firstly, if you go back to last May when all of this started, the month of May the price of gasoline moved 68 cents, and on average in the Midwest we saw the retail price move only 40 cents up in about a 4-week period. So it took 4 weeks, and it still didn't recover.

On the way down, in the last 2 weeks, since about the middle of the month, the numbers seem about right to me. We have seen the wholesale price drop about 40 cents. And in the Midwest, in total—it varies in different markets, we have seen a drop of about 20 cents in 2 weeks.

Mr. BARRETT. So you do expect to see it drop another 20 cents?

Mr. PILLARI. I don't want to predict or say what I expect.

Mr. BARRETT. Would you be surprised if it did?

Mr. PILLARI. I wouldn't want to say or predict what I expect.

Mr. BARRETT. Mr. Brown, you made a reference to predatory pricing. What were you speaking of there?

Mr. MARK H. BROWN. What I was speaking of specifically, as I think you pointed out, we perhaps have a supply and a demand imbalance, and I would be the last to sit here and attempt to accuse it on big oil. But I would say that your consumers, certainly in your market and a number of Midwest markets, are paying unnecessarily pricing. When you want to blame EPA for the RFG or if it is just the street battle, it is wrong.

Mr. BARRETT. Okay. Thank you, Mr. Chairman.

Mr. TAUZIN. Thank you, Mr. Barrett.

Mr. FRANK. We often have in this industry have investigations going on in the same State for predatory pricing and price gouging, simultaneously.

Mr. TAUZIN. At the same time. Thank you, Mr. Barrett.

Let me—this is part of the record, but I just want to reference it, because it helps in an understanding of the series of questions that we just asked and answered.

We have filed in the record the primer on gasoline prices that was prepared by EIA, and it breaks down in 1999 the price of a gallon of gasoline as follows: 37 percent is the average price of crude, although that varies a bit from 31 to 39 percent across the country depending upon other factors in the price; Federal and State taxes amount to 36 percent of the price of a gallon of gasoline; refining costs and profits amount to 13 percent, on average, again; distribution, marketing, retail station costs and profits, normally again amount to 14 percent. This is a breakdown prepared by EIA, an independent, as you know, voice within our Energy Department on energy information.

It further goes on to say that Federal, State and local taxes are a large component. Taxes, not including county and local taxes, account for 36 percent. Within this national average, Federal excise taxes are 18.4 cents, State excise taxes average 19.96 cents. There is a big impact of State taxes here. Also seven States levy additional State sales taxes, some of which are applied to the Federal



and State excise taxes. In addition, local county and city taxes can have significant impacts on the price of gasoline.

It goes on to say, Mr. Barrett, that only 28 percent of service station outlets today are company stations that are owned or leased by a major oil company and operated by its employees. Nearly 72 percent are owned by independent dealers, free to set their own prices. The price on the pump reflects both the retailer's purchase cost for the product and other costs of operating the service station. It also reflects local market conditions, which apparently is one of the big problems now in the Midwest, and factors such as the desirability of the location, market strategy of the owner, in this case some of the problems with dislocation.

I want to, before we close, take you through a couple of your testimonies and see if I can get a picture here.

In one of your testimonies, I think it was Mr. Frank, you pointed out that one of the problems you had that may have led to low inventories, and that could have led, Mr. Barrett, to shortages which may have created some of this ripple effect, was that the EPA regulations required you to virtually drain your tanks of the winter grade product before you could accept deliveries of the low vapor pressure summer grade of this gasoline in March or April.

In effect, you had to virtually empty your tanks and face the June 1 deadline for going to this second phase reformulated with empty tanks. That on June 1, if the delivery systems weren't perfect, we could almost predict there were going to be shortages, right, Mr. Frank?

Mr. FRANK. Yes, sir, that is right. The emptying of the tanks is because of the restriction. The tight specification on reformulating gasoline was much different than the winter grade gasoline.

Mr. TAUZIN. You can't mix them together.

Mr. FRANK. You can't have the mixing.

Mr. TAUZIN. So you had to empty your tanks. In effect, the regulations set the region up for conditions that almost predicted shortages.

Mr. FRANK. Yes, sir.

Mr. TAUZIN. Because if anything happened to supplies, and apparently a lot did, refineries went down, pipelines went down, fights over patented reformulated products—I noticed one of you mentioned a cut of—Mr. Thompson, you mentioned 4,000 barrels a day in a 15,000 barrel per day refinery. That is one-third. Nearly one-third of the refinery production was cut, is that right?

Mr. THOMPSON. No. No, sir, let me clarify that. At our Lake Charles, Louisiana, refinery, we have the capability of producing 15,000 barrels a day of summer grade RFG. We had to cut that to 4,000 barrels a day to avoid patent infringements.

Mr. TAUZIN. Wait a minute. You had to cut from 15 all the way down to 4?

Mr. THOMPSON. Yes, sir.

Mr. TAUZIN. So you cut two-thirds of the production.

Mr. THOMPSON. Yes, sir.

Mr. FRANK. Congressman, essentially what the Unocal patent has done was to patent the 1990 Clean Air Act, and that seems to be bad public policy to me.

Mr. TAUZIN. Well, that is something we can look at. I mean, here we have a patent problem that affected the capacity of the refiners by two-thirds to produce the material that should have been in the pipeline. We have the pipelines breaking, we have ship collisions in the port, and we have an EPA regulation that required you to empty the tanks before you could even depend upon those delivery systems. And we are going, why do we have a shortage?

Second, I want to understand this market. I tried to talk about it with the first panel, and we didn't have a lot of time, but maybe you can help me. I am told that when a shortage like that develops, that refiners—now some of you guys own refineries, you can help me here—that refineries obviously in a short production situation are more likely to take care your name brand stations rather than sell products to independent marketers. Is that correct?

Mr. FRANK. I would say that there is an obligation to supply your contract customers. But in Chicago we were selling bulk supplies to other refiners, and we were selling independent unbranded gasoline. In Detroit, in that situation, as others were running out, we lent gasoline to one of the refiner suppliers.

Mr. TAUZIN. In fact—I want to get you in here too, Mr. Pillari—I was told—and help me if this is true or not—that when those situations occur, that one of the incentives you have to go out and sell some of your product to other refiners or to other marketers, independents, is that they begin bidding up the price?

Mr. FRANK. Yes, sir.

Mr. TAUZIN. There is a shortage. They are not going to get any fuel, so they are going to have stations running on empty with this reformulated requirement, and you don't have enough to go around. So they start bidding up the price, right? Anyone jump in here and help me.

Mr. PILLARI. I would say, Congressman, instead of branded, I would use the term contract customers.

Mr. TAUZIN. That is a good correction. So it is not necessarily branded, it is contracted.

Mr. PILLARI. We serve our contract—

Mr. TAUZIN. You have to serve your contract stations, those you have an obligation to serve.

Mr. PILLARI. Because they have committed to us, and we have committed to them.

Mr. TAUZIN. So in order for the independents, who do not have a standard contract with you, to get fuel, they have to bid the price up. They have to somehow convince you and other refiners that it is worthwhile selling fuel to them, so they bid the price up.

Mr. PILLARI. That is right.

Mr. SCOTT. Mr. Chairman, my name is Greg Scott, just for the record. I had to replace Mr. Ports. He had a plane to catch.

When supplies get short, the independent marketers are generally the first to feel the pinch. So if Mr. Ports were here, he would tell you that as the supplies got short in the Midwest—

Mr. TAUZIN. You got hit first.

Mr. SCOTT. He has been hauling gasoline from West Virginia, from Tennessee, from Missouri, up into that market.

Mr. TAUZIN. He made the point in his statement that, while summertime Phase II RFG may cost only 5 cents per gallon for a re-

finer to produce, if the supplies of this gasoline fall short of demand in a particular market, like Chicago, St. Louis, then the price of the product will rise enough to attract necessary supplies from other markets.

So not only are you bidding with these refiners to get some of their supply but you are going out in other markets and bidding up the price in other markets, is that right?

Mr. SCOTT. That is correct.

Mr. TAUZIN. So that, having paid more for it to get it, you now have to translate into higher retail costs in the Chicago-St. Louis marketplace?

Mr. SCOTT. Based upon competition, yes.

Mr. TAUZIN. Now, this is the trick that intrigued me. When your contract stations—now, I am looking more to the refiners. When your contract stations now are faced with independent stations who now have significantly higher prices than they have, what is their problem? I am told they have a real problem with that. Could there be a run on their stations if they don't raise their prices? I am told that happens. Does that really happen in the marketplace?

Mr. FRANK. The same things happens at the terminal. We would call that an inversion, when the unbranded price of gasoline goes over the branded price.

Mr. TAUZIN. What happens then?

Mr. FRANK. Then the branded jobbers are buying brand gasoline at a lower price, and some of them elect to resell it to unbranded buyers.

Mr. TAUZIN. I am told this happens—and correct me if this is wrong, because I would love to know for the record. I am told that two things happen when the unbranded independent has to go out and pay more to get the product and therefore charges more at the retail pump for it—that the station across the street has to now be concerned about all those other customers coming over and buying up his cheaper product and draining his tanks.

Mr. FRANK. That is right.

Mr. TAUZIN. That he can no longer satisfy his normal customers. Is that a real problem?

Mr. FRANK. Yes, sir.

Mr. TAUZIN. And when that happens, he is incentivized to raise his own prices to match those of the independent who has, by necessity, bid the price up to get some product.

Mr. SCOTT. I would suggest, Mr. Chairman, one of two things will happen. Either the contract dealer will come up to the unbranded price, defensively, as you just suggested, or the independent is going to have to go down below his or her cost.

Mr. TAUZIN. Which means you take a loss.

Mr. SCOTT. Which means we are taking a loss on every gallon.

Mr. TAUZIN. Rather than taking a loss, if you can raise your price and if the others are incentivized to raise it with you, then you get what occurred in Chicago, Milwaukee and other Midwestern cities. You get this price spike going up, and you get prices in the retail market that far exceed the normal spread between wholesale and retail, is that right?

Mr. FRANK. Yes, sir. No supplier wants to be in the position of having to tell his customer that I don't have anything to sell you.

Mr. TAUZIN. That is my point. My point is, if everybody around me has raised their prices to \$1.70, and I am at \$1.50, there is no question that everybody is going to flock to my store. I am going to empty my tanks, and now my regular customers who show up the next morning come to me, and I can't take care of them, and I may, in fact, lose all my good will with my regular customers.

It creates an incentive for that dealer to raise his prices. He can maximize profits, why not do it while he can, and why not do it in order to hold your customers? That is basically the sort of the incentives that work in that kind of a strange marketplace, right?

Mr. FRANK. There is a tussle in the mind of every supplier that they go to to try to rationalize that situation.

Mr. TAUZIN. Therefore, the conclusion of Mr. Ports was that the EPA's manufacturing cost analysis, what we heard from Carol Browner, that this should have only cost 4 or 5 cents, that when they put in place the June 1 deadline, go to reformulated gas Phase II, and it should have only cost 4 or 5 cents, Mr. Ports' conclusion is those statistics are irrelevant if the gallons of gasoline—of the right boutique, I might add—do not or cannot reach the appropriate market. It is irrelevant, because the shortages start this chain reaction of spiraling up prices.

Mr. FRANK. Once the investments are made, you hope that everybody tries to recover the cost of that investment. But the cost has nothing to do with the selling price in a product short market.

Mr. TAUZIN. So we don't have a natural marketplace working.

Let me thank you. I simply want to conclude the hearing—I think all the members have worn themselves out, as well as I am sure you are very tired, too—with the request I know that Chairman Bliley would ask of you as we conclude this very long and very informative hearing.

The first request is that we are going to keep the record open. If you have additional comments—you heard a lot of discussion, you may want to add to the record, clarify some points, straighten out some incorrect information, supplement your statements.

Second, you have heard a number of members talk about we have seen enough finger pointing and blaming. What we are trying to do is find the causes and cure them. If you had to recommend to us—and I know you filed a recommendation to the EPA and to the Energy Department. If you had to recommend to us a series of policy decisions that might be achievable in a bipartisan fashion, not the kind of fights we are talking about over ANWR, we understand we are not going to achieve a solution there, but the kind of solutions that might make these marketplaces more rational and avoid the kinds of shortages that developed in California, now in the Midwest, and potentially across America, if you could tell us the one, two, three, four, five things we ought to do as legislators for this country, concerned as Mr. Barrett is, as we all are, about consumers getting ripped off, to make sure marketplaces work, what would that series of recommendations be?

If you can please do that in concise form for us, I think the hearings then have better meaning for all of us, because it tells us where we should go from here to avoid the next one.

I also want to thank—yes, the staff has reminded me, I should thank our electricity witnesses. We didn't ask a lot of questions

about electricity. We have had a lot of hearings and, as you know, a lot of potential markups of a electricity deregulation bill, so we focused on gasoline. But we thank you so much for being here.

Let me thank you all again. You have been extremely patient. Chairman Bliley and the entire committee wishes to again express its appreciation for your utmost patience and your contributions today.

The hearing stands adjourned.

[Whereupon, at 4:50 p.m., the committee was adjourned.]

[Additional material submitted for the record follows:]

BRIAN P. BILBRAY  
49TH DISTRICT, CALIFORNIA  
COMMERCE COMMITTEE  
SUBCOMMITTEE ON  
HEALTH AND ENVIRONMENT  
SUBCOMMITTEE ON  
FINANCE AND HAZARDOUS  
MATERIALS  
SUBCOMMITTEE ON  
OVERSIGHT AND  
INVESTIGATIONS



**Congress of the United States**  
**House of Representatives**  
**Washington, DC 20515**

**Statement of the Honorable Brian Bilbray**  
**Hearing on Summer Energy Concerns for the American Consumer**  
**House Commerce Committee**  
**June 28, 2000**

WASHINGTON OFFICE:  
1530 LONGWORTH HOUSE OFFICE BLDG.  
WASHINGTON, DC 20515  
(202) 225-2040  
FAX (202) 225-7848  
DISTRICT OFFICE:  
1011 CAMINO DEL RIO SOUTH  
SUITE 230  
SAN DIEGO, CA 92108  
(619) 281-1430  
FAX (619) 291-8856  
INTERNET:  
E-mail:  
brian.bilbray@mail.house.gov  
World Wide Web:  
<http://www.house.gov/bilbray/>

Mr. Chairman, thank you for convening this hearing today, and providing Members with the opportunity to ask some questions of these esteemed witnesses, and hopefully come away with some further explanation of the matters at hand. I look forward to addressing some questions to our former colleague from New Mexico, Secretary Richardson, and also to our good friend Administrator Browner; we have much to discuss. I wish to be brief, but there are a several points I'd like to make to the Secretary and the Administrator.

One of my chief concerns at this moment has to do with our electricity supply. As I'm sure my colleagues are aware, California has again made headlines with our ongoing heat waves, and the accompanying strains these high temperatures have placed on the energy grid. As the attached article from the Wall Street Journal indicates, just two weeks ago, with temperatures reaching above the 100 degree mark in San Francisco, Pacific Gas and Electric chose to initiate rolling "brown outs" in their service territory throughout northern California, in order to protect against a sizeable blackout from occurring statewide. Yesterday, and probably right now, southern California is experiencing the same high temperatures and resulting increased demand for electricity, and Southern California Edison has been asked by the California Independent System Operator (ISO) to engage in "load curtailment" practices, which translates to having to ask certain customers to reduce their consumption or turn off their power entirely.

Unfortunately, the supply of available power has not kept pace with the increased demand for electricity. The one positive development to come out of this situation is that the utility companies in California (Sempra/San Diego Gas and Electric, Southern California Edison, and Pacific Gas and Electric) have been able to work closely with the California ISO to ensure reliability of the statewide grid, via a comprehensive and strict protocol. However admirable these reliability measures, these policies nonetheless do not address the underlying problem - the lack of transmission and generation capacity.

As Congress and the Administration work to resolve these problems at the federal level, through national electricity restructuring legislation, distributed generation and interconnection must be a core part of the solution. Distributed generation will play a crucial role in expanding our supply of electricity, and can do so by employing new and more environmentally friendly technologies. Once in place, distributed generation will also have the added benefit of reducing overall energy costs to the consumer. I would ask that this June 25 article from the San Diego Union Tribune

also be added to the record.

Mr. Chairman, let me just say that I appreciate the opportunity you have provided me to work closely with my colleagues and industry on this issue, and I look forward to further understanding the perspective of Secretary Richardson on this issue.

I'd now like to shift my attention to that other commodity which is of some passing interest to my constituents, and that is gasoline and its cost. Administrator Browner, I have here three separate letters, dated January 14, March 1, and June 20 of this year, which I would ask to be included in the hearing record. The first of these is signed by 41 members of the California delegation, and the last two by myself and my northern California colleague Anna Eshoo. The topic, as I'm sure you can guess, is the California cleaner-burning gasoline waiver, which has been pending before you since April 12, 1999. A February 24, 2000 response to our January letter from Assistant Administrator Perciasepe stated in part that "we hope to complete our assessment by early summer". I continue to be extremely frustrated with the glacial pace at which EPA is conducting its assessment of this waiver, and will hope for some enlightenment as to when my state might expect to be able to proceed with the extensive decision-making process needed in order to plan for fuel supplies in upcoming years. EPA's failure to act quickly has left California in a state of limbo, unable to begin planning for future demand and supply.

My already considerable interest in this issue has been heightened by the recent attention paid to skyrocketing gasoline prices across the nation, particularly in the midwest, where prices have climbed to upwards of \$2 per gallon, similar to what my own constituents in California have been experiencing for some time now. The constituents of my colleagues from this region are understandably unhappy at these developments, and I'm sure we'll have an opportunity for them to direct questions at our witnesses here today. I am specifically interested in one development which should be of great interest to the Committee, which has devoted so much time and energy to the critical issue of improving our air quality.

The Washington Post reported on June 14<sup>th</sup> that the Governor of Illinois has called on the federal government to suspend environmental rules mandating cleaner-burning gasoline, which he has blamed for driving up prices at the pump. I would ask that this article be included in the record. This request is now before the EPA, so I hope that Administrator Browner is prepared to comment on it. I would also wonder, as the Administration is apparently considering granting such a request to the State of Illinois, how long such a process would take. Again, I would point out that the California waiver request, which is backed by exhaustive and irrefutable scientific evidence, has been sitting at EPA since April 12, 1999. That is over 14 months ago, and so precedent would seem to indicate that EPA would be unable to act on Illinois' request in anything resembling a timely fashion.

Let me make a couple of observations here - first, the State of California is seeking to move to an even cleaner version of its cleaner-burning gasoline, which far surpasses in terms of emissions reduction, the Phase II regulations for reformulated gasoline which the Governor of Illinois has asked to be suspended. The entire California delegation, in both the House and the Senate, supports legislation (HR 11 and S. 266) which I and Senator Feinstein have introduced, that

would allow the regulations for California's own cleaner-burning gasoline to serve in lieu of the less stringent Phase II federal rules, so long as the California gasoline continues to meet or exceed the federal emission requirements. This same broad and bipartisan California coalition strongly supports a request by our Governor, Gray Davis, of an administrative waiver which would accomplish the same thing. This Administration, led by the EPA, has stalled and impeded consideration of the legislation for four years, and is now moving at a snail's pace to consider Governor Davis' waiver request. Let me again stress to my colleagues that California is seeking to adopt more stringent standards, in order to provide even greater levels of air quality protection. I certainly can't speak for all of my colleagues, but I am comfortable stating that in California, there would be great concern over a suggestion that we "roll back" our environmental protections, particularly in the Clean Air Act, just because of a temporary increase in the price of gasoline.

For example, I have here a June 5, 2000 article from the Los Angeles Times, the headline of which reads: "Studies Link Heart Attacks To Moderate Air Pollution." Recent data has indicated that even moderate air pollution, at levels common to many cities in both California and the midwest, may trigger sudden death by changing heart rhythms in people with existing cardiac problems. Given these alarming scientific developments, Mr. Chairman, it hardly seems appropriate to entertain notions of suspending or rolling back any of our clean air safeguards. I would ask that this article also be included in the record.

Mr. Chairman, I have two additional articles which I would ask to be included in the record. The first of these is from the June 21 San Francisco Chronicle, and the headline reads: "Gas Costs Soar Nationally, But Hold Fast Here. State, U.S. Prices Nearly Even For First Time In Years". This makes the important point that California has been dealing with high gas prices for some time. It also contains the following quote from the director of the California Energy Institute in Berkeley "The Midwest is going through what we went through in 1996 - conversion to a new fuel, with all the headaches that go with it." In other words, what is going on in the midwest is not particularly unique, and it has already been weathered in California.

The second article, also from the Chronicle and dated June 22, is headlined: "State Wonders Why White House Didn't Probe High Gas Prices Here". As will be further elaborated, Mr. Chairman, California gas prices were nearing \$2 a gallon back in April, and while Californians were concerned, no federal action was taken. While high prices in California are nothing new, unfortunately, the speed with which the Administration has rushed to investigate the current high prices in the midwest has galvanized consumers and public interest organizations alike across the state. I would hope that our witnesses are able to speak to this discrepancy as well.

Mr. Chairman, no one ever said that clean air was going to be easy, or inexpensive for that matter. California's experience is testament to this. But this is the path Congress has chosen, since 1970, and the air quality benefits which have been derived from it are priceless. To retreat from this now would set a terrible precedent, damage the faith and health of the American people, and undermine the very foundation of the Clean Air Act, the crown jewel of our environmental laws. I yield back my time, and look forward to the testimony of our witnesses.



## California Ponders Lowering Price Cap On Power as Hot Spell Raised Tempers

By Rebecca Smith  
Staff Reporter

LOS ANGELES—California's paid roughly \$800 million for electricity during a five-day hot spell earlier this month that pushed parts of the electric system to the brink of collapse. The high cost—at least three times as much as was paid during the costliest week in 1999—is rekindling a rancorous debate about whether the state's cap on wholesale prices is set too high.

On Wednesday the board of the California Independent System Operator will take up the matter and consider a recommendation to reduce the maximum price that it will pay for power to \$250 per megawatt hour from today's \$750.

Other markets are wrestling with the price-cap issue, too. On June 30, the board of New York's grid operator is expected to consider a measure that could impose a price cap of \$1,000 per megawatt hour.

In California, the ISO first imposed a "damage control" cap of \$250 per megawatt hour in the summer of 1996 after the price of power in the state's newly deregulated market soared as high as \$9,999 per megawatt hour. That stacks up to be \$9.99 per kilowatt hour instead of the usual three to five cents.

Economists concluded there weren't enough generators bidding against each other to produce competitive prices, thus caps were needed to prevent gouging. In September, the California ISO raised the

bid ceiling to \$750 per megawatt hour, under pressure from generators who threatened to take their power projects elsewhere unless the market was allowed to "track the economy on Page A8."

But the high cost of energy racked up during the last heat wave were from the cap to its old level. More than \$800 million was spent on power in a day-ahead market, mostly by utilities that have sold off their power plants and now buy energy for their customers on the open market.

In addition, the California ISO spent \$200 million to obtain emergency power needed to stabilize the system. Even so, it

Please Turn to Page A8, Column 1

## California Considers Power Prices

Continued From Page A8

couldn't get enough electricity to keep voltage levels from slipping dangerously low in the San Francisco area. The voltage level at a key substation serving the Bay Area slumped 22,000 volts from 242,000 volts to 220,000, says a spokesman for the area's chief executive of the California ISO.

Afraid of electric collapse in the area, the California ISO ordered rolling blackouts throughout the San Francisco area.

A state legislator who helped write the state's deregulation law—and who now sees residential bills in his home district of San Diego jumping from an average of \$40 in May to \$80 or \$90 in June—says that many costs are "grossly understated." So far, the California ISO to raise the bid cap to \$250 retroactive to May 1.

Another proponent of lowering the cap is Southern California Edison, a unit of Edison International of Rosemead, Calif. Under the state's deregulation law, rates still are frozen in Edison's territory while

it pays down its debts. Therefore, every dollar it spends on energy, for now, is one dollar less it has available to pay down its own debts, giving it special sensitivity to prices.

Generators and power marketers, including Houston-based Enron Corp., opposed raising the price cap—unless it is to be retroactive. They say a shortage of power turbines means plants will get built first in markets offering the highest prices. Therefore, California would only be adding to its troubles by chasing away new generation by further restricting prices.

Not all generators are threatening to pack up if the cap is reduced. One of the most ambitious constructors of new plants, Calpine Corp. of San Jose, Calif., says his company is not making any business decisions. It wants to be "in the cost producer in every market." "I'm glad to hear others may be going away," says Pete Cartwright, Calpine chairman, adding, "It'll be good for us because we'll still be there."



## Act quickly to keep lights on

**San Diego's energy supply is being strained, endangering its economy**

SAN DIEGO UNION-TRIBUNE

By Jessie Knight

June 25, 2000

San Diego's strong regional economy has attracted new technology and manufacturing industries, as well as a rich supply of high-paying jobs. In turn, this has placed significant demands on the region's infrastructure, especially our energy supply. While our energy supply may be reliable in the short run, we need to begin planning now how to meet the regional needs of the future.

We must act quickly to take proactive steps to ensure our region the power it needs for the future. The situation is serious and well-documented. The California Independent System Operator (ISO), the organization charged with ensuring power reliability throughout the state, considers the San Diego region to be one of the areas where the energy supply and grid situation are most vulnerable. If we do nothing, San Diego will face serious energy shortages by 2004 and our growing economy may face an obstacle it cannot overcome.

The California Energy Commission, the California Public Utilities Commission, and the California ISO are charged with the responsibility of reviewing and approving new initiatives to improve energy-system reliability. We should strongly encourage these agencies to implement an integrated and comprehensive approach to address the energy needs of San Diego, considering such alternatives as:

- Increasing San Diego's transmission capacity to enable energy suppliers to import more electricity into the region;
- Building more generation facilities in the San Diego area;
- Encouraging greater use of energy-efficiency technologies to keep new demand to a minimum;

▪ Aggressively exploring the use of new distributed generation technologies, such as fuel cells and micro-turbines to absorb part of the need for new sources of energy.

In a recent report, the ISO indicated that a combination of the above options will be required to meet San Diego's growing energy needs.

It is a priority for the San Diego Regional Chamber of Commerce to ensure that measures are taken to address this pressing need. In order to attract high technology and manufacturing companies to San Diego, as well as retain existing ones, we must augment the amount of power we generate locally.

An excellent near-term solution is the construction of the Otay Mesa Generating Project, a 510-megawatt natural gas facility located in the remote eastern portion of Otay Mesa, 1.5 miles north of the U.S./Mexico border. Through the use of new technologies, the facility will be nearly twice as efficient and ten times cleaner than the older plants that are currently operating in San Diego County. PG&E National Energy Group, one of the largest developers of power plants in the country, is now nearly half way through its certification process by the California Energy Commission. There will be no risk borne by the taxpayers to build this new plant. Under California's new deregulation rules, private developers bear most of the risk.

The Otay Mesa Generating Project provides San Diego with an excellent opportunity to address our demand for reliable electric energy. There is no feasible generating alternative at this time that will benefit San Diego faster or address our region's complicated situation better. There is no doubt that additional power is needed now. Failure to act quickly and permit the construction of a new facility in San Diego would be an unforgiving missed opportunity for residents and businesses of all types.

The Otay Mesa Generating Project will provide San Diego with the ability to continue to power our growing economy for years to come.

Recently, San Diego Gas & Electric received approval to proceed with design and siting work on a new transmission line connecting the electric grids of Orange County and San Diego, called the Valley-Rainbow project.

Although only 25 miles in length, this new line will give San Diego access to power plants all over the Western United States. This transmission line received approval last week from the Independent Systems Operator as the preferred new "wires" alternative for San Diego. The Valley-Rainbow project alone would provide San Diego with the power it needs until 2008.

The issues, though, are larger than just securing needed energy -- there also is the question of keeping our energy costs low. For several years, California has been restructuring its electricity utility industry, in part to drive energy prices lower through competition and create more options in the marketplace.

More competition in the industry should encourage the development of new energy supply options for the region and provide downward pressure on electric prices in the future. Several promising projects already are on the drawing board. In the medium to long term time frame, fuel cell and micro turbine technologies will evolve to become additional sources of commercial power generation. While not commercially viable at this time, these new technologies will help meet our future energy needs and reduce dependence on single source generation facilities.

What does all this mean to San Diego consumers?

It means that they need to focus their attention on energy issues and take the time to become involved in crafting the solutions to meet San Diego's future energy needs. It also means that they need to encourage regulators and their elected officials to act quickly on these new energy-supply projects, and not get bogged down in bureaucratic red tape, so that we can secure San Diego's energy and economic future.

*Knight is CEO of the Greater SD Chamber of Commerce and former president of the California Public Utilities Commission.*

---

Copyright 2000 Union-Tribune Publishing Co.

Congress of the United States  
Washington, DC 20515

January 14, 2000

The Honorable Carol Browner, Administrator  
U.S. Environmental Protection Agency  
401 M Street, SW  
Washington, D.C. 20460

Dear Administrator Browner:

As members of California's congressional delegation, we are writing regarding EPA's ongoing deliberations over California's request for a waiver of the Clean Air Act's 2% oxygenate mandate, and to encourage your swift and favorable resolution of this matter.

Relief from the 2% oxygen mandate is without question in the environmental and economic best interests of our constituents statewide, as has been clearly and exhaustively documented over the last four years by the science and legislative history underlying H.R. 11 and S.266, which enjoy the support of the entire California congressional delegation. This was further underscored by the information which accompanied the State's initial waiver request of April 12, 1999, as well as the supplemental technical and analytical material which EPA had requested and was provided on December 24, 1999, by the California Air Resources Board.

The modeling and analysis contained in this supplemental material breaks down into simple terms the substantial air quality benefits, particularly in reductions of oxides of nitrogen (NOx), which California would realize without the existing 2% oxygen mandate. This same analysis also demonstrates that without relief from the mandate, continued application of the 2% oxygen requirement (and the subsequent loss in reductions of NOx) will interfere with California's ability to achieve timely attainment of the national ambient air quality standards (NAAQS) for ozone and particulate matter. In sum, the State has clearly demonstrated that both its recently-approved Phase 3 regulations for cleaner-burning gasoline and the current Phase 2 regulations can achieve substantially greater reductions in NOx and other emissions, if the oxygenate mandate is lifted. Additionally, CARB's findings indicate that failure to lift the oxygenate mandate will have the added effect of prolonging and disrupting the State of California's timetable for the removal of MTBE from state gasoline supplies, resulting in considerable cost to California consumers.

In a November 19, 1999 letter to Commerce Health and Environment Subcommittee Chairman Michael Bilirakis, Assistant Administrator Robert Perciasepe stated that "Once CARB has submitted their additional information, we will work expeditiously to complete our technical analysis of their request. Should we conclude after that analysis that the federal RFG oxygen content requirement will "prevent or interfere with" California's attainment of a primary NAAQS, it is our intention to propose approval of the State's waiver request pursuant to EPA's authority under Section 211(k)(2)(B) of the Clean Air Act".

Given CARB's submission of this additional information to EPA on December 24, and subsequent information provided this month, we respectfully submit that EPA now possesses all the technical and scientific information necessary to render a clear decision in support of lifting the 2% oxygen mandate for California. We believe that a waiver for California is justified, given its unique air quality challenges, and it is our expectation that any waiver issued should be reflective of the exhaustive supporting documentation provided by CARB, and without condition or caveat which might render it unacceptable to the State of California's unique air quality needs.

Given the economic and environmental urgency of this issue to our home state, we are strongly supportive of the swiftest favorable resolution possible. However, in the absence of a clear resolution of this matter, we will continue to pursue all avenues, including the aforementioned legislation, in order to provide California with the ability it needs to strengthen its already stringent air quality strategies, mitigate gasoline costs to the consumer, and protect its public health and environment.

We appreciate your attention to this important issue, and thank you in advance for your consideration.

Sincerely,

<u>Diana Bellamy</u>	<u>Donna Christensen</u>
<u>Dana G. Esch</u>	<u>Ellen O. Tauscher</u>
<u>Lori Eggen</u>	<u>Jimmy Luvit</u>
<u>David Druin</u>	<u>Chin Cox</u>
<u>Tom Campbell</u>	<u>[Signature]</u>
<u>Pete Stark</u>	<u>Zoe Lofgren</u>

<u>Barbara Lee</u>	<u>Bob Felner</u>
<u>Grace F. Kaplitz</u>	<u>Randy 'Lucky' Lanning</u>
<u>Howard L. Brown</u>	<u>Luella Ryback-Allen</u>
<u>Julian C. O'Connell</u>	<u>Lynn Woolsey</u>
<u>Wade Shomper</u>	<u><del>James M. Lanning</del></u>
<u>Ed Hill</u>	<u>John T. Doolittle</u>
<u>Tony Lee</u>	<u>Mary Bono</u>
<u>Steve Hall</u>	<u>Gregg Jackson</u>
<u>Stephen Horn</u>	<u>Buck <del>Horn</del></u>
<u>Sam Brown</u>	<u>Matthew J. Martinez</u>

Duncan Hunter Don Packard

Robert J. Matsui Wally Hager

Bill Thomas Don Ralston

Sam Farr Loretta Sanchez

Ken Calvert

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_





UNITED STATES ENVIRONMENTAL PROTECTION AGENCY  
WASHINGTON, D.C. 20460

FEB 24 2000

OFFICE OF  
AIR AND RADIATION

The Honorable Brian Bilbray  
U.S. House of Representatives  
Washington, D.C. 20515

Dear Congressman Bilbray:

Thank you for your letter of January 14, 2000, co-signed by forty of your colleagues, concerning the State of California's request for a waiver from the Clean Air Act oxygenate requirement for reformulated gasoline (RFG). We understand California's desire for an expeditious resolution of this matter and are pleased to provide the following status report.

On February 9, 2000, the Environmental Protection Agency (EPA) received additional supporting documentation which completes California's application for a waiver of the oxygen requirement. As you know, under the Clean Air Act, EPA may waive the oxygen mandate, in whole or in part, "...upon a determination by the Administrator that compliance with such requirement would prevent or interfere with the attainment by the area of a national primary ambient air quality standard [NAAQS]."

In order to make this determination, the Agency must conduct an independent evaluation of the data and modeling, as well as the other information submitted by the state in support of its request for a waiver from the federal RFG oxygen requirement. We hope to complete our assessment by early summer. Based on our productive discussions with the California Air Resources Board up to this point, we fully expect that we will meet this schedule. If EPA determines that the statutory conditions to grant the waiver are met, we will then be required to provide public notice of our decision. Such procedures include a comment period of at minimum thirty days.

As we proceed with our evaluation, please feel free to contact us if you have any questions.

Sincerely,

A handwritten signature in dark ink, appearing to read "Bob Perciasepe".

Robert Perciasepe  
Assistant Administrator

Congress of the United States  
Washington, DC 20515

March 1, 2000

Mr. Robert Perciasepe  
Assistant Administrator for Air and Radiation  
U.S. Environmental Protection Agency  
1200 Pennsylvania Avenue NW  
Washington, D.C. 20460

BY FAX

Dear Mr. Perciasepe:

We are in receipt of your February 14<sup>th</sup> letter to California EPA Secretary Winston Hickox, in which you confirmed receipt on February 9<sup>th</sup> of "California's completed application for a waiver from the RFG program's oxygen requirement in the Clean Air Act." Your letter also states that, "In order to make this determination, the Agency must conduct an independent evaluation of the data and modeling as well as the other information submitted by the state in support of its request for a waiver from the federal RFG oxygen requirement. *We hope to complete our assessment by early summer* (emphasis added)."

This protracted timetable is not acceptable. California needs certainty on this issue now, and has more than adequately demonstrated as much. We are aware that California submitted a comprehensive waiver request to EPA on April 12, 1999, and that based on subsequent discussions with EPA staff, provided additional technical information on several occasions late last year and earlier this year. We are also aware that these more recent submissions have been tangential to EPA's continuing consideration of the underlying waiver request and should not warrant the additional and extravagant amount of time you suggest is required to "assess" them.

At the same time, we are aware that EPA is apparently pursuing two separate rulemakings on this issue, which are now pending at the Office of Management and Budget. The first of these would reportedly allow EPA to utilize the Toxic Substances Control Act (TSCA) to limit or eliminate use of MTBE as a fuel additive. The other, and far more mysterious proposal, would apparently allow for a "reformulated gasoline adjustment," which is widely rumored to consist of a carbon monoxide offset for ethanol.

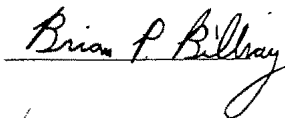
These two proposals—neither of which have been shared with the Commerce Committee, members of the California delegation, or the State of California—do not appear to be reflective of the strong scientific, content-neutral, and performance-based case California has made since 1996, and is pursuing via legislation and waiver request, for relief of the 2% oxygen requirement in order to best fulfill its clean air strategies and address its groundwater concerns. This case is further validated by the report of EPA's own prestigious Blue Ribbon Panel on Oxygenates in Gasoline, which was released on July 29, 1999, and contains this conclusion: "Within California,

lifting the oxygen requirement will result in greater flexibility to maintain and enhance emissions reductions, particularly as California pursues new formulation requirements for gasoline." We are dismayed at the evident lack of consideration of this well-documented science in EPA's pending proposals, and at EPA's lack of urgency regarding California's waiver request, which is evident in your letter of February 14.

While we recognize that the focus of this Thursday's Health and Environment Subcommittee hearing is on the national implementation of the RFG program, we nonetheless are confident that it will afford us an opportunity to hear from you on our serious aforementioned concerns and for you to help us to better understand EPA's reasoning and intent on this critical California public health issue.

Thank you for the attention you have paid to our concerns in the past. We look forward to working with you to expeditiously resolve the aforementioned issues concerning California's waiver request.

Sincerely,



cc: The Honorable Tom Bliley  
The Honorable John Dingell  
The Honorable Michael Bilirakis  
The Honorable Sherrod Brown  
Mr. Winston Hickox, Secretary, California EPA  
Mr. Michael Kenny, Executive Officer, California Air Resources Board



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY  
WASHINGTON, D.C. 20460

MAR 21 2000

OFFICE OF  
AIR AND RADIATION

The Honorable Brian Bilbray  
U.S. House of Representatives  
Washington, DC 20515

Dear Congressman Bilbray:

Thank you for your March 1, 2000, letter regarding the status of California's request for a waiver from the federal oxygen requirement in the reformulated gasoline (RFG) program. We hope this letter clarifies the situation.

As you know, the Environmental Protection Agency (EPA) may waive the oxygen mandate, in whole or in part, "...upon a determination by the Administrator that compliance with such requirement would prevent or interfere with the attainment by the area of a national primary ambient air quality standard [NAAQS]." In order to make a decision on the request for waiver, EPA needs to fully evaluate the technical and legal basis for the request. This includes a detailed assessment of the technical and legal analyses supporting the request. The request submitted by Governor Davis on April 12, 1999, did not contain the technical analysis to demonstrate how the oxygen requirement prevents or interferes with the attainment of the NAAQS in California.

Subsequent to the April 12 request, the California Air Resources Board (CARB) submitted documents in support of the waiver request on July 9, 1999. On an October 15, 1999, conference call with CARB, however, we learned that the general assumptions stated in CARB's July 9 submittal to EPA were no longer applicable. In a conference call held on November 9, 1999, CARB staff said they were producing a technical analysis to support the approach described during the October 15 conference call, which would reflect the properties of CARB's Phase III RFG. They agreed that EPA action on the waiver request would be delayed, pending receipt and review of the new analysis from CARB. We received the new analysis on December 24, 1999. Because the new analysis was based on entirely new assumptions, it was not "tangential" to the previous information, rather, it was substantively different and required the Agency to begin our evaluation at a new point.

After reviewing the information submitted to EPA by California on December 24, EPA determined that additional information was needed from CARB in order for the Agency to conduct a thorough technical review of the request. The additional information needed was defined in a January 20, 2000 memorandum to Winston Hickox.

Subsequently, EPA staff met with CARB staff on January 24 and 25, 2000, regarding these issues. This process was completed on February 9, 2000, when California submitted all the information necessary for EPA to begin its comprehensive review.

In order to make the determination of prevention or interference with a NAAQS as required by Section 211(k)(2)(B) of the Clean Air Act, the Agency must conduct an independent evaluation of the data and modeling, as well as the other information submitted by the state in support of its request for a waiver from the federal RFG oxygen requirement. This evaluation involves a rigorous statistical evaluation of California's Predictive Model, as well as a thorough assessment of other issues that pertain to the waiver request. We are proceeding with these analyses.

Finally, you mention the Agency's proposal for an RFG adjustment. EPA is considering a proposal which would implement the National Research Council (NRC) recommendation that the contribution of CO to ozone formation be recognized in assessments of RFG air quality benefits. If the Agency decides to move forward with this proposal, it would be published in Federal Register and solicit public review and comment on its content.

I hope this information is useful. I encourage you to contact us if you have further questions.

Sincerely,

A handwritten signature in black ink, reading "Robert D. Perciasepe" followed by a stylized flourish in parentheses.

Robert Perciasepe  
Assistant Administrator

Washington, DC 20515

June 20, 2000

The Honorable Carol Browner, Administrator  
U.S. Environmental Protection Agency  
401 M Street, S.W.  
Washington, D.C. 20460

Dear Administrator Browner:

We noted with interest recent trade press articles regarding correspondence and meetings between yourself and a group of our colleagues from midwestern states, and have had an opportunity to review their most recent letter to you, dated May 19, urging your opposition to the State of California's long-pending request for a waiver of the 2% oxygenate requirement.

You are well aware of our longstanding concern and frustration over the length of time it is taking EPA to process California's waiver request. We want to take this opportunity to again call your attention to the exhaustive and irrefutable body of scientific and environmental evidence in support of the waiver which the State of California has painstakingly assembled and presented to EPA. As we stated to you in a previous letter dated March 1 of this year, we remain extremely dissatisfied with the prolonged timetable EPA has indicated will be necessary for consideration of the waiver, and again urge you to act expeditiously in order to allow our State to proceed with timely implementation of its progressive and stringent clean fuels strategies.

We greatly appreciate our midwestern colleagues' concern for the health of California's air and water quality; however, there were several statements or implications in their May 19 letter to you which we felt merited some clarification. First is the implication that by achieving removal of the 2% oxygenate requirement, through either the waiver or H.R. 11, California will somehow be biased against increased ethanol use. As you are well aware, given continued demand for oxygenates in gasoline as a result of the State's own wintertime oxygen program, this is inaccurate. The California Air Resources Board's own numbers show that California ethanol use, which is currently minimal, will increase dramatically in such a scenario (see attached chart). Given Governor Davis' timeline for phasing out MTBE use entirely, California regulators and refiners concur that ethanol will be used to supply the state's considerable demand for oxygenate content. Without relief from the 2% oxygenate requirement, however, phasing out MTBE will result in an effective "ethanol mandate", which as you are aware, would result in harmful air quality impacts and additional increases in gasoline prices statewide.

Additionally, we certainly understand our colleagues' urgency to ban MTBE and replace it with ethanol, in order to "protect" groundwater supplies. We are quite aware of the presence of MTBE in groundwater in a number of areas around our state; however, we believe that it is critical that we learn from this experience and not repeat past mistakes, by replacing one known problem with another potential problem. For example, in March of this year the California State Water Resources Control Board issued an advisory (copy attached) to underground storage tank operators warning of a potential incompatibility of ethanol-blended fuels with some underground storage tanks. The advisory reads in part "*if your UST system is not compatible with this fuel, there is higher risk of damage to your UST system and the environment.*"

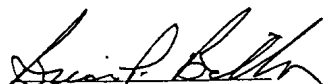
Given such unanswered questions, and knowing too well of the existing problems of MTBE contamination, it is clear that from a water quality standpoint simply replacing one additive with another is hardly a practical or satisfactory solution. Only by getting out from under the 2% oxygenate mandate can California achieve the flexibility it needs to ensure protection of its water supply and its clean air strategies.

Finally, our colleagues' letter concluded by stating "if you are sincere in your intent to expeditiously reduce the use of MTBE and replace it with ethanol, you will promptly deny the (California) waiver request." We are unaware of any statement by you of an intention to "replace MTBE with ethanol" in California, and are confident that your completed analysis of the California waiver request will result in a clear decision providing California with the flexibility it needs in order to best implement its clean fuels strategies and protect its groundwater supplies.

We appreciate the sincerity of your commitment to California's clean air strategies, and wish to underscore our continued concern with the pace of EPA's consideration of the California waiver. Our state must have this flexibility in order to continue its progressive actions on behalf of the public health and environment. We reiterate our desire for a speedy issuance of a clean waiver of the 2% oxygenate requirement to the State of California, and thank you in advance for your expedited consideration of this request.

Sincerely,

  
Congresswoman Anna Eshoo

  
Congressman Brian Bilbray

enclosures (2)

## Overview of Current and Expected Ethanol Use in California Under H.R. 11

### Current Oxygenate Use In Non-Federal RFG Areas

About 30 percent of California's gasoline consumption is outside of current federal RFG areas. Of this 30 percent, about 3.5 billion gallons of gasoline per year, or about 25 percent of the State's total, is oxygenated with 11 percent MTBE. However, in Northern California, small amounts of regular grade gasoline are being supplied without oxygenates.

### Current Ethanol Use:

Currently, ethanol is used in very small quantities in California's gasoline supply. The majority of ethanol use occurs in the San Francisco Bay area (which is a non-federal RFG area), where approximately 50 retail gasoline stations are supplied exclusively with California Phase 2 reformulated gasoline blended with ethanol. As can be seen from Table 1, this accounts for approximately 1 to 1.4 million gallons of ethanol per year (depending on the fuel oxygen content), and contrasts to the approximately 470 million gallons of MTBE used in the remaining non-federal RFG areas within California.

### Expected Ethanol Use:

The ARB has estimated the most likely use of ethanol (for both 2.0 and 2.7 weight percent oxygen) in the year 2003 under H.R. 11 (as of 10-22-99). The results are summarized in Table 1. Under H.R. 11, we assume that ethanol would be used in the wintertime in the South Coast region (because of carbon monoxide non-attainment), in all premium grades of gasoline statewide (approximately 30% of California's gasoline consumption) to provide octane enhancement, and in some portion of mid-grade gasolines (i.e., not all mid-grade would be oxygenated). The estimated ethanol usage under H.R. 11 is between 340 and 670 million gallons per year. This is the most likely estimate of future ethanol use in California.

**Table 1**  
**Current and Expected Ethanol Use in California Under H.R. 11**

Scenario	Ethanol Volume (million gallons per year)	
	2.0 Weight Percent Oxygen	2.7 Weight Percent Oxygen
1999 Current Ethanol Use in California	1.0	1.4
2003 Under H.R. 11: Statewide use in Premium Grades, + wintertime use in South Coast, + some use in mid-grade gasolines.	340	670

Note: 2.0% by weight oxygen (5.7% ethanol by volume) and 2.7% by weight oxygen (7.8% ethanol by volume) correspond to two of the three "cut points" for ethanol tax credit.





## State Water Resources Control Board

Division of Clean Water Programs  
2014 T Street - Sacramento, California 95814 - (916) 227-4350  
Mailing Address: P.O. Box 944212 - Sacramento, California - 94244-2120  
FAX (916) 227-4349 - Internet Address: <http://www.swrcb.ca.gov>



RECEIVED MAR 22 2000

March 2000

### ADVISORY TO UNDERGROUND STORAGE TANK OWNERS/OPERATORS REGARDING ETHANOL-BLEND FUEL COMPATIBILITY

The purpose of this advisory is to notify you that some underground storage tank and piping (UST) systems may not be compatible with ethanol-blend fuels. As MTBE is phased out of gasoline, ethanol is a likely replacement fuel oxygenate. Gasoline supplied to some parts of California already has ethanol added at concentrations as high as 10 percent by volume. If your UST system is not compatible with this fuel, there is a higher risk of damage to your UST system and the environment. Therefore, we strongly urge you to verify that your entire system is compatible with the ethanol-blend fuel before you store it in your UST system. You may be able to obtain compatibility information from the equipment manufacturer (see list attached). If you are unsure whether your current or future supply of fuel contains or will contain ethanol, you should check with your fuel supplier.

Based on the review of available compatibility testing information, industry literature, and other published research papers, the compatibility of some of the following UST system components with the ethanol-blend fuels should be verified:

- Single-wall fiberglass tanks installed prior to 1/1/1984
- Single-wall fiberglass and flexible piping installed prior to 1/1/1984
- Lining material used to line old single-wall tanks for repairs or upgrade
- Adhesives, glues, sealants, and gaskets used around the piping and other parts of the UST system (more of a concern for older systems, but may be an issue for the new installations as well if the contractor failed to use proper material)
- Pump heads and other auxiliary equipment, including certain metals (e.g. aluminum, copper, some brasses/bronzes, etc.), that come in contact with the product
- Older models of some leak detection equipment that may not operate properly or its parts that may wear out with exposure to ethanol-blend fuels.

If you don't have compatibility records in your files, we strongly recommend that as UST owners/operators you ask the respective equipment manufacturer(s) for a written compatibility statement for ethanol-blend fuels before you begin storing that type of fuel. You should also ask for information regarding maximum concentrations of ethanol that your system can be exposed to, the industry testing standard, and the testing process by which the manufacturer supports the above statement. Keep a copy of this information for your records.

If you have difficulty obtaining this information in writing from the manufacturer you may seek assistance from your local agency. You may address your questions regarding this advisory to your local agency or Shelia Farahmak at (916) 227-4350.

  
James George Giannopoulos, Chief  
Regulatory Programs Branch

**California Environmental Protection Agency**

400 Sacramento Street

# Los Angeles Times

4  
SUNDAY  
MONDAY, JUNE 5, 2000  
COPYRIGHT 1999 THE TIMES PUBLISHING COMPANY / CC / 96 PAGES

170

## Studies Link Heart Attacks to Moderate Air Pollution

■ **Health:** Particles apparently can alter rhythms in weak or diseased hearts, even at levels common in L.A., other cities.

By MARLA CONE  
TIMES ENVIRONMENTAL WRITER

Even moderate air pollution routinely found in many U.S. cities may trigger sudden deaths by changing heart rhythms in people with existing cardiac problems, according to extensive new scientific research.

The finding, backed by more than a dozen studies on humans and animals, suggests that heart attacks, not lung disease, may be the most serious medical threat posed by air pollution.

The culprits appear to be tiny pieces of soot called particulates. Scientists caution that the link between heart problems and air pollution remains a strong likelihood—

not a certainty. More research is underway.

But the emerging evidence could have particular importance for the Los Angeles region, where residents breathe some of the worst concentrations of ultra-fine particulates in the nation, largely because of diesel trucks.

Severe particulate pollution also exists in many other urban and desert areas, including the Coachella Valley, Philadelphia, Chicago, New York City, Salt Lake City and Phoenix, which in 1998 surpassed Riverside for the nation's highest particulate levels.

Research continues to show that air pollution can cause serious lung problems. But as an overall threat  
Please see POLLUTION, A13



LUIS SINCO / Los Angeles Times

Researcher Cheryl Terrell monitors Evelyn Gould as Gould is exposed to air pollution in a Downey lab.

## POLLUTION: Studies Link Particulates in Air to the Danger of Heart Attacks

Continued from A1

to public health, the danger to the heart appears to be more weighty because of the sheer numbers of people with heart disease. Cardiovascular disease is the No. 1 killer in the United States, responsible for nearly half of all deaths.

Changes in heart rhythm that occur after breathing particle pollution are subtle on an electrocardiogram, and a healthy person is unaffected. But for someone with a compromised or diseased heart—especially an elderly person—the impact could have deadly consequences, researchers say.

"When particulate pollution increases, the heart rate seems to go up a little bit and the variability in the heart rate seems to go down. Those are things classically seen [in people] with heart failure," said Dr. Timothy Denton, a cardiologist at Cedars-Sinai Medical Center in Los Angeles.

Experts have estimated that particulate pollution may cause 1% of heart disease fatalities in the United States. That fraction is small but would amount to 10,000 deaths a year. In Los Angeles County, on average, 77 residents

die from cardiovascular disease each day.

"If you believe the calculations, particulate-related death is a serious public health problem—more serious than any other pollutant like ozone or sulfur dioxide or carbon monoxide," said Dr. Henry Gong, a USC medical professor who is a leading expert on the health effects of air pollution.

Epidemiologists in about 70 cities around the world consistently have found that more people die and are hospitalized during periods when particulate pollution rises even a moderate amount.

Rarely does such a clear pattern emerge in epidemiology, and most experts are now convinced that it is not a coincidence.

"For air pollution to have such a substantial impact on public health, and have it show up so consistently, is remarkable," said Daniel Costa, chief of the Environmental Protection Agency's pulmonary toxicology branch.

The sudden-death phenomenon has been reported for nearly a decade. Only within the last year have scientists begun to figure out why.

Tiny, ubiquitous particles of

soot—from diesel trucks, cars, industrial plants and perhaps even windblown dust—seem to alter the normal pulsing of the heart, the emerging research shows.

At pollution levels commonly found in U.S. cities, inhaling particles appears to disrupt the body's ability to regulate the pumping of blood. As particulate counts rise on any given day, a vital indicator called heart rate variability decreases in some people, disturbing the beat-to-beat variations that are designed to meet the demands of activities ranging from sleep to exercise.

The threat seems particularly acute for elderly people who have arrhythmia—a life-threatening condition of skipped or premature beats—or the combination of a weak heart and lung disease such as asthma.

One of the most frightening aspects of heart rhythm irregularities is that they can kill quickly, without warning.

"Studies suggest that people are dying relatively rapidly after you see an increase in particles. Sometimes it's within 24 hours," said

Please see POLLUTION, A16

## POLLUTION: Heart Attacks Linked

Continued from A15

Robert Devlin, chief of human studies at the clinical research branch of the U.S. Environmental Protection Agency.

In the past year, about a dozen major scientific studies have turned up heart pattern changes in animals exposed in laboratories and in elderly people tested in nursing homes. Several more studies are about to be published.

### Skepticism Turns to Suspicion

According to one groundbreaking study of 100 patients in Boston, conducted by the Harvard School of Public Health, when particle pollution increased, elderly people with pacemakers suffered more arrhythmia.

In another study, 26 seniors at a Baltimore nursing home wore heart monitors for three weeks. Their heart rate variability decreased on and around days when particulate levels were higher, according to a study by the University of North Carolina and the EPA.

"I started out skeptical, but I'm starting to think there's something really there," said Brigham Young University epidemiologist Arden Pope, who studied elderly patients in Provo, Utah. "We have strongly suggestive evidence now that there's an impact on the heart."

Robert McWherter is about as vulnerable to particle pollution as anyone can get. He's 80, suffers from heart disease and chronic bronchitis, and lives in Indio, a desert town with high levels of microscopic particles from dust whipped up by spring winds. Like many retirees, McWherter moved to the Coachella Valley to protect his health, unaware that particulates there may be harming his heart.

"My heart muscle is pretty well shot," said McWherter, who has undergone both a quadruple and a triple bypass but stays in shape by walking outdoors and lifting weights in a gym.

McWherter is one of 23 cardiac patients in the Coachella Valley who are wearing heart monitors one day a week for three months. They are volunteers in a new state study testing whether elderly people in the desert are endangered on high-particle days.

In March, during the worst of the



As two recorders sit on his fireplace, Robert McWherter, 80, i

windy season, McWherter's heart monitor detected skipped beats. No one knows whether the particles were to blame, but taking part in the experiment probably saved his life because the abnormalities were found. McWherter wound up being fitted for a pacemaker.

Some environmental health researchers and doctors say cardiologists should advise patients such as McWherter to avoid exertion on days with high particulate counts. In the Coachella Valley, particulate pollution peaks in the spring. In the Los Angeles Basin, it peaks in the fall and winter, when many residents mistakenly believe the sky is clean because traditional smog strikes most heavily in the summer.

But Denton of Cedars-Sinai, one of the few cardiologists to study the link between heart rhythm and particulates, said the findings are too preliminary to base medical recommendations on them.

"Based upon the data we have, there's no need [at this time] for us to change a patient's behavior or treatment," said Denton, who is a consulting cardiologist for the state's Coachella Valley test. "Maybe in a year or so it could [warrant doctors' warnings], if we get better data."

In much of the research on the heart rhythm theory, animals have served as scientific surrogates.

Rats with simulated heart dis-

ease died from arrhythmia when exposed to single doses of highly concentrated smokestack particles in EPA tests. The rats started out with normal heartbeats, but within half an hour their hearts went haywire, skipping beats and contracting prematurely.

### Fashioning Tests for Human Volunteers

The rats were exposed to pollution levels hundreds of times higher than what any person would encounter. But in another experiment, dogs with simulated coronary artery disease showed "very significant changes in EKGs" after breathing elevated levels of particulates no higher than those found in many U.S. cities, said Daniel Greenbaum, director of the Health Effects Institute, a Massachusetts research group that funded the study at Harvard.

Studies of rats and dogs, however, have limited value because their hearts differ from human hearts. As a result, scientists are now fashioning creative experiments using human volunteers.

An as yet unpublished EPA study offers some of the most compelling evidence so far that particles can affect heart rhythm. Elderly volunteers were tested in

## to Particles



GINA PERAZZI / Los Angeles Times

if Indio wears a heart monitor.

special pollution chambers using air collected in North Carolina. Even when they were exposed to a dose found in many urban areas, their heart rate variability was worse than when they were exposed to clean air.

Younger volunteers showed no heart changes, even at the highest doses.

Although the changes detected in beat variability "were not huge," some persisted for at least a day after exposure and they are "very significant" for human health because low heart rate variability often occurs in people who are about to suffer heart attacks, said Devlin, who directed the study.

A similar study is underway at Rancho Los Amigos Medical Center in Downey, where elderly volunteers are being exposed both to clean air and to air with 200 micrograms of ultra-fine particles per cubic meter—the Los Angeles Basin's "worst-case scenario."

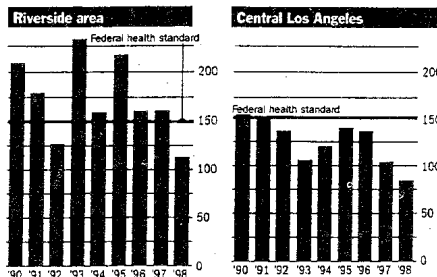
Experiments like this are the closest that science comes to proving a cause and effect between pollution and heart effects.

Researchers are just now trying to understand how particles could affect the heart.

The most popular theory is that when particles enter the lungs, some part of the nervous system

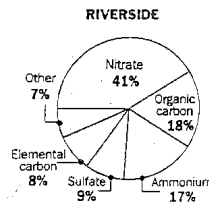
## Particle Pollution

Fine particulates have fouled the Los Angeles Basin's air for decades, especially in the Riverside area. Here are peak concentrations per year for 1990-98, measured in micrograms of particles per cubic meter of air.



### What's in Particulates

- **Nitrate:** Mostly from cars and diesel trucks
- **Organic carbon:** From auto and truck exhaust and from petroleum-based solvents and paints
- **Elemental carbon:** Mostly from diesel engines
- **Ammonium:** From animal waste
- **Sulfate:** From factories and motor vehicles
- **Other:** Mostly dust, soil and salt



Source: South Coast Air Quality Management District

LYNN MEERSMAN / Los Angeles Times

reflexively sends an impulse to the nerve center in the heart that controls contractions. This reflex raises the pulse rate and lowers the variability of the heart rate.

### Examining Particle Size, Content

Also, inhaled particles cause lung inflammation, which can release agents into the blood that are carried into the heart. Blood also seems to thicken and clot differently upon exposure, according to some studies.

Particulates may be dangerous because of fragments of metals such as iron that are contained in soot. But some researchers believe it is the size of the particles, not the content, that causes the harm, and

that microscopic road dust could be just as hazardous as truck exhaust.

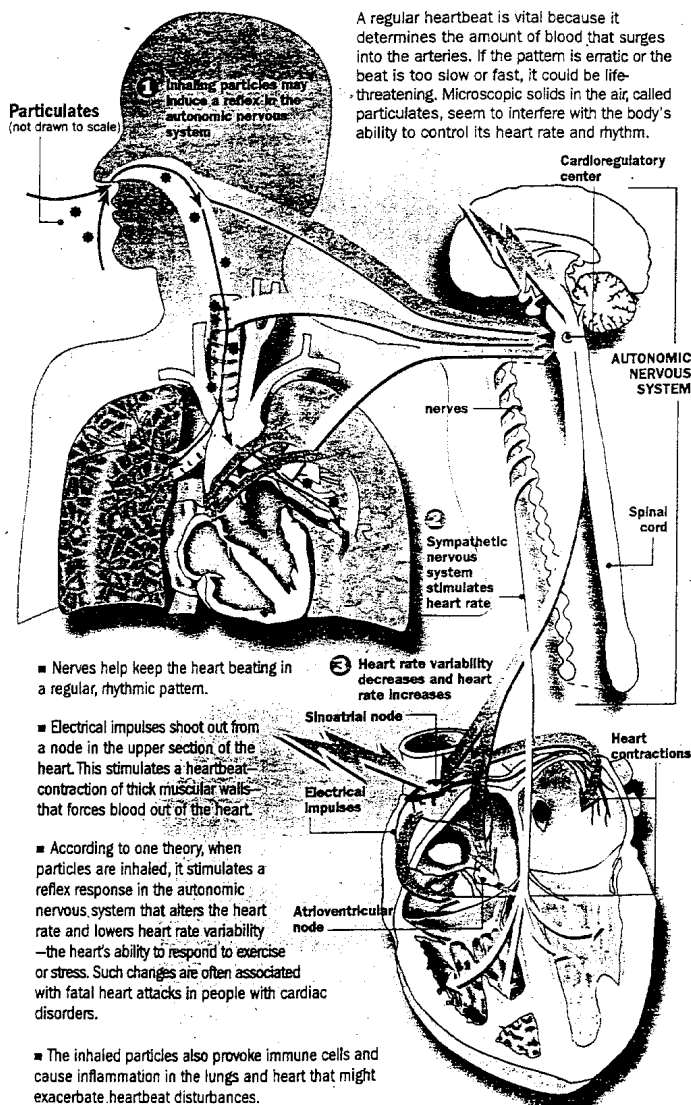
Air pollution regulators say they need the answers to help them decide how to target efforts to clean up particulate pollution. Billions of dollars from corporate and public interests—from utilities to the trucking industry—are at stake.

To public health officials, the new findings are disturbing because they suggest that moderate, everyday concentrations of a pollutant can be lethal.

But epidemiologist Pope says if the link between air particles and heart attacks is proved, "it's incredibly good news."

"We already know that about half of us die of cardiopulmonary disease, and if this is true about particulates, we have found a preventable cause," he said.

## Pollution and the Heart



Source: U.S. Environmental Protection Agency/Experimental Toxicology Division

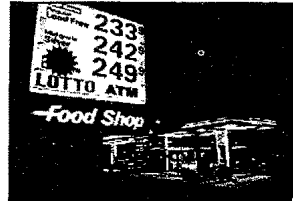
LESLIE CARLSON / Los Angeles Times



## Illinois Seeks the Suspension Of New EPA Gasoline Rules

By William Claiborne  
Washington Post Staff Writer  
Thursday, June 15, 2000; Page A02

CHICAGO, June 14 — Illinois Gov. George H. Ryan (R) today called on the federal government to suspend environmental rules mandating cleaner-burning gasoline, which he blamed for driving pump prices in parts of the Midwest above \$2 a gallon, the highest in the United States.



Gasoline prices tell their own story at a station in Chicago's Bucktown neighborhood. (Scott Olson - Reuters)

Ryan blamed the high midwestern pump prices, particularly in Chicago and Milwaukee, on Environmental Protection Agency gasoline production rules that went into effect June 1 in scattered locations across the country. The regulations are aimed at curbing toxic emissions.

[E-Mail This Article](#)  
[Printer-Friendly Version](#)

Ryan said that while the EPA's anti-pollution goals were laudatory, the agency should delay mandating an improved version of so-called reformulated gasoline until governments in the region can study the impact on prices.

Under the reformulated gasoline program, the base fuel is mixed with either ethanol or the chemical agent MTBE, an oil-based substance that has been found to pollute groundwater supplies. Most midwestern states have opted to use ethanol. Ryan said he had talked with the governors of Wisconsin, Indiana, Nebraska and Kansas, and that all of them support the rules suspension proposal.

Ryan said refineries in the Midwest could revert to producing an earlier version of cleaner-burning reformulated gasoline, which he said could be sold more cheaply than the new version.

"This current craziness in prices doesn't make any sense," Ryan told a news conference here. "I can't understand why we should pay 80 cents a gallon more for gas than other parts of the country."

A Clinton administration official said the waiver request is before the EPA and, for now, the White House has no comment.

Last week, the average price of self-serve gasoline in Chicago was \$2.13 a gallon, up from \$1.37 a gallon in January. In contrast, prices averaged \$1.56 a gallon in Los Angeles, \$1.42 in Atlanta and \$1.61 in Boston.

Some downtown service stations here were charging \$2.39 a gallon for regular gasoline and \$2.59 a gallon for self-serve premium, meaning that filling a 44-gallon tank in a sport-utility vehicle costs more than \$114.

Industry officials attributed the rising prices to market and regulatory forces that they say converged just as the start of the summer driving season began to put a strain on gasoline inventories.

The officials said the most significant of these was the June 1 implementation of a new federal requirement for a cleaner-burning reformulated gasoline--called RFG-2--which in the Midwest entails the use of corn-based ethanol as an additive and is more difficult to blend than earlier versions of reformulated fuels. Urvan Sternfels, president of the National Petrochemical and Refiners Association, today said refiners had made the "unpleasant discovery" that because ethanol evaporates more quickly than other additives, the blending process required complicated--and costly--adjustments to a process with which the refiners had little experience.

However, environmental groups such as the Clean Air Trust have demanded to know why the oil companies failed to provide for adequate supplies when they had known for five years they would have to make the cleaner-burning gasoline available to consumers by June 1.

Sternfels also said the rupture of an oil pipeline near Dallas, a pipeline that Midwest refineries had used to build up their inventories, had contributed to the price surge. "It slowed down the system and put us behind the curve in terms of supply," Sternfels said.

He also said that court decisions upholding patents awarded to California-based Unocal Corp. on reformulated fuel blending processes have had a "chilling effect" on many refineries, which are worried about having to pay royalties of as much as 7.5 cents a gallon if their processes are too similar to Unocal's.

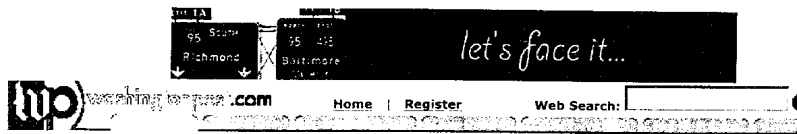
All of these factors have combined to tighten the supply of reformulated gasoline, making the market nervous and forcing prices upward, Sternfels said.


However, Energy Department officials said that while stocks of reformulated gasoline were tight nationally--41.4 million barrels, or 3.3 million barrels fewer than last June--Midwest stocks were at 2 million barrels, slightly more than at this time last year.



Robert Perciasepe, the EPA's assistant administrator for air and pollution programs, said this week after meeting with officials from eight major oil refineries that while gasoline supplies are lower than normal nationally, there is enough fuel to keep prices in check. He said reformulated gasoline costs only 5 to 8 cents a gallon more to produce than conventional gasoline.

© 2000 The Washington Post Company





## The Chronicle Marathon 2000

### Marathon? Split the Distance? Relay?

**Gas Costs Soar Nationally But Hold Fast Here**  
**State, U.S. prices nearly even for 1st time in years**

Wednesday, June 21, 2000

San Francisco Chronicle  
 CHRONICLE SECTIONS

David Lazarus, Chronicle Staff Writer

For the first time in about a decade, the average price of a gallon of self-serve unleaded regular gas in California is almost the same as the national average -- a result of soaring prices elsewhere, not any sudden break for long-suffering Golden State motorists.

Printer-friendly version  
 Email this article to a friend

Backflip this page  
 to find it again

In the past month, the California average fell one penny to \$1.66, while the national average surged by 15 cents to \$1.64, according to the Northern California branch of the American Automobile Association.

And if you go by the U.S. Energy Department's weekly survey of gas costs

--which uses a smaller sample than the automobile association's survey -- California pump prices are now below the national average by as much as 6 cents.

The last time California and national gas prices were this close was in 1991, when the statewide average was \$1.15 and the national average was \$1.14.

Bay Area drivers may no longer be watching gas prices ratchet ever higher, but they're still feeling the pinch at the pump. While Northern California gas prices have dropped 2 cents to an average \$1.71 in the past month, that's still 25 cents above year-ago levels.

"It's not like we're having a grand old time here," said Severin Borenstein, director of the University of California Energy Institute in Berkeley. "As long as oil prices are this high, I don't expect us to get a real break any time soon."

With representatives of the Organization of Petroleum Exporting Countries meeting today in Vienna to discuss global oil supplies, the price of oil rose \$1.36 on the New York Mercantile Exchange yesterday to \$33.05 a barrel

--the highest closing price in more than three months.

Average gas prices in the U.S. have spiked sharply higher as Midwest states introduce reformulated fuel similar to the environmentally friendly blend that has helped push California pump prices through the roof.

However, the two mixtures are not the same. California's emissions standards are still stricter than the federal standard being adopted elsewhere.

"The Midwest is going through what we went through in 1996 -- conversion to a new fuel with all the headaches that go with it," Borenstein said.

Even so, the Clinton administration suspects that some price gouging on the part of oil companies may be to blame as well for the sky-high Midwest gas prices.

The Federal Trade Commission announced late yesterday that it has opened a formal investigation into the matter. Subpoenas could be issued to oil-company executives within days.

Chicago now has the dubious distinction of having the nation's most expensive gas: as high as \$2.33 for a gallon of self-serve regular unleaded.

Pump prices also are hitting record highs in Milwaukee, Detroit and other Midwest cities.

San Francisco, by comparison, is getting off relatively easy. The average gas price in the city fell by a penny over the past four weeks to \$1.85, according to the automobile association.

The price in Oakland declined 2 cents to \$1.77, while in Concord it was unchanged at \$1.67, in Santa Rosa it was down a penny to \$1.71 and in San Jose it was 4 cents lower to \$1.75.

Bay Area gas prices generally run higher than other parts of the country because of a combination of reformulated fuel and limited competition among service stations.

But as the Midwest grapples with introduction of new fuel, coupled with shortages caused by pipeline troubles, the Bay Area looks instead like a model of efficiency.

"It's not so much that our prices are down but that prices in other parts of the country are way up," said Paul Moreno, a spokesman for the automobile association.

For California as a whole, he said smooth operations at refineries statewide have helped push gas prices a few cents lower, despite increased summertime demand.

"California is now ranked 16th in the nation for gas prices," Moreno said. "This is unusual. California is almost always in the top five."

The state's ranking may soon climb. Moreno said rising oil prices, along with increased demand resulting from school being out, should result in higher charges at the pump within weeks.

"There's been a slight upward trend in West Coast wholesale prices," agreed Alan Kovski, energy analyst with the Kiplinger Washington Letter. "I would expect gasoline prices to go up a bit. Not a whole lot, but some."

Even so, the UC Energy Institute's Borenstein said Bay Area gas prices likely will not fluctuate much. "I think OPEC is much more together than they were before," he said. "Don't expect any bargains."

*E-mail David Lazarus at davidlaz@sfgate.com.*

Gas Costs Soar Nationally But Hold Fast.../State, U.S. prices nearly even for 1st time in year Page 4 of 4

#### CHANGE IN BAY AREA GAS PRICES

City/Region	6/20/00	5/16/00	6/99
Bay Area	\$1.75	\$1.78	\$1.46
Concord	\$1.57	\$1.67	\$1.44
Lake Tahoe	\$1.70	\$1.69	\$1.51
Oakland	\$1.77	\$1.79	\$1.51
Sacramento	\$1.66	\$1.68	\$1.37
San Francisco	\$1.85	\$1.86	\$1.50
San Jose	\$1.73	\$1.79	\$1.50
San Mateo	\$1.83	\$1.84	\$1.57
Santa Rosa	\$1.71	\$1.72	\$1.49
U.S.	\$1.64	\$1.49	\$1.14

Source: RAA Northern California. Monthly gas price averages for a gallon of regular unleaded, self-service gasoline.

©2000 San Francisco Chronicle Page A3

Chronicle Sections 

Feedback  
A-100 Rate





## State Wonders Why White House Didn't Probe High Gas Costs Here

Thursday, June 22, 2000

San Francisco Chronicle  
CHRONICLE SECTIONS

David Lazarus, Chronicle Staff Writer

When Bay Area gas prices soared to a record \$1.86 a gallon in April, there were no accusations of price gouging from the White House, no talk of subpoenas being issued to oil-industry executives and no far-reaching political uproar.

But when gas prices in the Midwest rocketed into the same stratosphere this week, Washington went into full hissy-fit mode, demanding action.

"It's an election year," said Tyler Dann, an oil-industry analyst with Banc of America Securities in Houston, Texas. "This whole thing is a politically motivated event."

Be that as it may, California consumer advocates expressed frustration yesterday that Washington waited until now to embrace gas prices as an important issue.

"It's certainly unfair," said Dan Jacobson, consumer program director for the California Public Interest Research Group in Sacramento. "It would have been great for the federal government to look at this earlier, when California drivers were getting gouged at the pump."

Although state Attorney General Bill Lockyer launched a probe into California's sky-high gas prices -- resulting in no immediate solutions -- the federal government has been virtually silent regarding the plight of Golden State motorists.

"We're perceived as being a rich area," said Linda Sherry, spokeswoman for Consumer Action, a San Francisco grassroots organization. "People pooh-pooh our representatives when they say, 'poor Bay Area.'"

· [Printer-friendly version](#)  
· [Email this article to a friend](#)

[Backflip this page to find it again](#)

**RELATED ARTICLES**  
powered by *Autonomy*

05/09/2000 - [Few legal options vs. gas prices.](#)

03/15/2000 - [Gas Prices Rise to Historic Highs.](#)

03/11/2000 - [Oil Prices Presage Expensive Summer.](#)

02/06/2000 - [New Chevron chief takes bullish view.](#)

[>>more related articles...](#)

In fact, the Federal Trade Commission launched an investigation into California's high gas prices more than two years ago, in part due to pressure from California Sen. Barbara Boxer.

But that probe is all but invisible compared to the FTC's high-profile assault on pump prices in the Midwest.

Mitch Katz, a spokesman for the commission in Washington, D.C., said the California probe is a "nonpublic investigation," which means that the FTC is not required to announce its findings, or even to confirm whether a probe is under way at all.

In contrast, confirmation of the Midwest probe came from no less an authority than FTC Chairman Robert Pitofsky, and members of Congress have been told that subpoenas of oil-industry executives will be issued shortly.

"The California investigation is different from the investigation in the Midwest because it's a significantly more complicated type of investigation," Katz said.

He declined to say how the California case is more complicated than that of the Midwest, or why the Midwest probe appears to have been given a higher priority.

Katz added that no details of the West Coast investigation would be divulged by the FTC.

But in a letter to the FTC chairman yesterday, Boxer noted that "numerous" subpoenas for oil-industry pricing documents have been issued as part of the California investigation, and that "evidence of harassment and intimidation" has been uncovered relating to oil companies' treatment of independent dealers.

"While I understand that building a complex antitrust case takes considerable time, I am disappointed that the FTC's investigation has not yet concluded and brought tangible results for California consumers," she said.

In a separate statement, California Sen. Dianne Feinstein called on the FTC to examine recent jumps in gas prices nationwide "and to ensure that consumers in California and the Midwest are not subject to undue price hikes."

As gas prices climbed past the \$2 mark in the Chicago and Milwaukee areas, Vice President Al Gore adopted a considerably more assertive tone in a statement issued late Tuesday.

"I am extremely concerned about the conduct of the oil companies that may have led to these unreasonable price increases," he said.

Noting that oil company profits surged by nearly 500 percent in the first half of the year, Gore said that "these enormous and unreasonable profits suggest that big oil is gouging American consumers."

For his part, Republican presidential rival Gov. George W. Bush of Texas told reporters in Los Angeles yesterday that Gore himself is partly to blame. "I want to remind people that this administration is devoid of an energy policy," he said.

Bush also faulted the Clinton administration for being unable to spur the Organization of Petroleum Exporting Countries to boost production.

OPEC ministers, meeting in Vienna, agreed yesterday to increase output by 3 percent, or about 700,000 barrels a day. But analysts said this would do little to reduce pump prices in the United States.

"We don't think it's enough," said Banc of America's Dann. "If you think prices today are uncomfortable, they're going to stay uncomfortable for the summer."

The Northern California branch of the American Automobile Association said Tuesday that Bay Area gas prices are holding steady around an average \$1.70 for a gallon of self-serve regular



unleaded

--about 25 cents above year-ago levels.

"When California was trying to draw attention to high gas prices, the rest of the nation wasn't experiencing the same thing and so it wasn't seen as a big problem," said Paul Moreno, a spokesman for the association.

"Maybe with what's going on in the Midwest right now, that will change," he said.

*E-mail David Lazarus at [davidlaz@sfgate.com](mailto:davidlaz@sfgate.com).*

[next/](#) [previous](#) article in Chronicle section

©2000 San Francisco Chronicle Page A10

Chronicle Sections

Feedback  




**EAST BAY** NEIGHBORHOOD GUIDES  
from Berkeley See, Shop, Eat, Live  
[www.sfgate.com](http://www.sfgate.com)

STAR WARS EP  
SPY WHO SHAGGED



P.O. Box 3758  
Tulsa OK 74102-3758

**CITGO Petroleum Corporation**

July 18, 2000

The Honorable Thomas J. Bliley  
Chairman  
Committee on Commerce  
2125 Rayburn House Office Building  
Washington, DC 20515

Re: June 28, 2000, Hearing on Summer Energy Concerns – **ENERGY POLICY**

Dear Mr. Chairman:

I am pleased to provide you with extensions to my remarks provided at the referenced hearing, and have enclosed responses to three questions asked by members of the hearing panel.

Let me begin by saying that I believe the nation is in desperate need of a comprehensive energy policy that has regulatory reform as a centerpiece. The petroleum-refining sector is grossly over regulated by an uncoordinated and, often counterproductive, regimen of federal, state and local laws and regulations. Unless U. S. policy is amended many major petroleum companies will leave this sector to importers and others. I urge you to carefully review the enclosed recommendations for regulatory reform and the specifics on several particular rules that, if left unchecked, promise to cause additional fuel supply problems in future years.

I sincerely hope that the concerns that I have expressed will serve as a warning, and that the appropriate action is taken to ensure that this nation does not face a protracted period of product outages and volatile prices. I believe, if government and industry work together to implement sound regulations, this nation can have both clean air and adequate supplies of clean fuels.

I would be pleased to provide you any additional information that could further our nation towards a sensible energy policy.

Jerry Thompson  
Senior Vice President  
Development and Technological Excellence

Encs.

Attachment 1

**Reply to Representative W.J. Tauzin of Louisiana's request for recommended changes to the U. S. Energy Policy****A New Regulatory Policy Is Urgently Needed**

To maintain the supply of the petroleum products that keep the nation moving, and to ensure the continued viability of the nation's petroleum refining system, changes in regulatory policy are necessary.

The coordinated implementation and integration of environmental rules and regulations is absolutely necessary to ensure that U.S. energy needs are met. Higher energy prices that disrupt the American consumers' budgets can be avoided with a correction in the direction of regulatory policy.

The current "command and control" regulatory system is ill suited to address the nation's remaining environmental concerns in a practical way. New rules covering air emissions and fuel formulations are wrecking havoc on the nation's petroleum refineries. These new rules (see attached chart) are on top of the over 120 health and environmental rules that have already been imposed on the refining and marketing industry. Government agencies at all levels must adopt processes to analyze and prioritize risks, and then subject proposed solutions for the highest risks to a thorough cost/benefit analysis. Comprehensive reform legislation has been under discussion in Congress for several years but no progress has occurred.

Adding regulations that are not cost effective on top of existing rules damages the refining industry's ability to compete in world markets. Many major petroleum companies are divesting refining and marketing assets because of their low profitability while others are merging operations or entering into partnerships to maintain economic viability. The current regulatory direction will cause the U.S. to be dependent on even greater percentages of imported motor fuels.

The government can reduce the potential for market volatility by making environmental regulations more reasonable and workable. Improved regulations would give companies more flexibility to adjust to problems that may have temporary impacts on supply and price. This applies especially to fuels regulations, including EPA's new diesel sulfur proposal, which sets a standard beyond what the technology will support. Congress should mandate and police federal agencies' adoption of these principles:

1. **Prioritization:** Regulations should address the greatest concerns first. The refining industry has been so highly regulated since 1970, I feel we have far exceeded the point of diminishing returns and that greater environmental improvement can be gained through regulation of other sectors.
2. **Use Current Data:** Regulatory priorities and risk assessments must be based on sound science and the most current data. This would include allowing time for the benefits of existing rules to be realized before imposing new regulatory programs addressing the same concern. No regulation should be finalized unless a favorable risk assessment using the best science and a realistic cost benefit analysis demonstrates that the most reasonable regulatory alternative has been selected. When performing regulatory analysis based on technologies

that have not been commercially proven, the level of uncertainty surrounding costs and performance should receive careful evaluation.

3. **Cost/Benefit Analysis:** The current regulatory system is inefficient and outdated. Some recent environmental rules have costs that are far in excess of expected benefits. A new system that carefully balances the total anticipated cost of compliance (capital plus maintenance) over a specified time frame against the total anticipated benefits to be derived from implementation over the same time frame will provide a framework to ensure a strong and competitive economy.
4. **Stakeholder Involvement:** State and local governments should have a more active role in setting environmental priorities and enforcement. In addition, regulators must identify all "sources" of a particular concern and include those sources in their rulemaking even if they are beyond the scope of the current "regulated community" or "sources."
5. **Flexibility:** Regulations should set performance requirements, but allow for the creation of innovative solutions to reach those goals. The regulated community is in a better position to find solutions to environmental/health concerns. In addition, regulations must provide adequate lead-time for scoping, technical option evaluation, design, engineering, financing, permit acquisition, equipment procurement, field construction, and start-up. Four years is the minimum time necessary after finalization of requirements for implementation of significant refining industry investment. The required lead-time can be longer as the magnitude of the investment increases.
6. **Accountability:** Each regulation should include an automatic sunset provision that can be overridden, if necessary. Each of the regulations would be subject to a "post implementation audit" to determine the effectiveness of the regulation as compared to the initial identification, prioritization and cost/benefit analysis.

Environmental policymakers are responsible to society at large—of which the business community is a vital part. The responsibility of policymakers extends not only to devising laws and regulations that improve public health and the environmental, but also to determining their impact on the nation's economic and energy resources. Politics and not science drives too many of our nation's regulatory policies and priorities. For example, EPA is charged with ensuring a healthy environment for all citizens. The responsibility for energy supplies falls, however, to the DOE, whose advice is frequently ignored by the EPA. The DOE and EPA should equally share responsibility for new fuel policy that can be cost effectively manufactured and distributed throughout the nation. These agencies should also heed petroleum industry advice on fuel policy.

#### **Specific Recommendations:**

- **Harmonize Regulations** - Fuel quality changes and the necessary investment must be appropriately sequenced with minimum overlap. The Tier 2 Rule gasoline sulfur reduction and other product specification changes should not be mandated for implementation in the same time frame, otherwise permitting, engineering, and construction resource constraints will likely result in higher costs, inability to meet the mandated schedules, and product supply disturbances. Other environmental regulations, such as the Refinery MACT phase II rule, should likewise be sequenced with other similar pollutant control rules as well as fuel regulations. Without regulatory harmony many refining and marketing companies will quit the business leading to more regional supply shortages.

While not overlapping the implementation requirements, the EPA should finalize the timing and specifications for on- and off-highway diesel sulfur reduction and MTBE use as soon as possible. Potential efficiencies exist for providing support facilities common to these programs and gasoline sulfur reduction.

- **Regulatory Certainty** - Regulations should include certainty in scope, timing, and requirements, to allow the refining and distribution industries to make effective investment decisions. Regulations that introduce uncertainty into the outlook for required product qualities or product demands will increase the hesitancy of individual companies to invest. For example, the Tier 2 Rule includes an expectation that the EPA will develop a future provision dealing with gasoline sulfur cap flexibility during processing unit downtimes. Until the flexibility that such a provision might provide is known, refiners are unable to plan effectively for necessary facilities.

Likewise, the EPA should clarify its position on individual state fuel requirements. Currently there is potential for state action that could undermine the Tier 2 Rule credit banking and trading provisions, and this potential creates uncertainty for investment planning.

- **Very Low Sulfur Gasoline and Diesel Requirements** - Requirements for reducing gasoline or on-highway diesel sulfur below 30 ppm average should not be imposed until significantly more study can be completed to provide a basis for sound conclusions about the cost, benefit, producibility, and deliverability of products with very low sulfur levels. There is a significant risk of inadequate supplies should on-highway diesel sulfur levels below 30 ppm be mandated.
- **Gasoline Driveability Index (DI)**- The current DI specification should not be changed until additional study can provide a sound basis for thorough analysis of the cost effectiveness and potential impacts on supply of any change. Refinery modeling in this study predicts high cost to reduce average DI. While there may be potential to lower this cost by reducing testing and operational variability, this potential is not sufficiently understood to support sound regulatory analysis.
- **Environmental Justice** - The EPA should be prepared to promptly address and resolve environmental justice claims that arise during the permitting process. The EPA should support state and local agency decisions where environmental justice issues have been addressed during the permitting process.
- **Emission Offsets** - A portion of the emissions reduction resulting from use of lower sulfur fuels should be allowed as an offset to the stationary source emissions resulting from the new facilities required to produce the lower sulfur fuels. The EPA, state and local agencies, and industry members should work jointly to identify additional action steps to provide timely permitting while continuing progress toward meeting environmental goals.
- **EPA Enforcement Policy** - The requirements for New Source Review (NSR) should not be retroactively reinterpreted. The EPA Enforcement Division should recognize the validity of netting refinery-generated internal offsets against emissions from new facilities, as discussed in the Tier 2 Rule preamble. Use of agency guideline documents with unjustified reviews of

- **EPA Enforcement Policy** - The requirements for New Source Review (NSR) should not be retroactively reinterpreted. The EPA Enforcement Division should recognize the validity of netting refinery-generated internal offsets against emissions from new facilities, as discussed in the Tier 2 Rule preamble. Use of agency guideline documents with unjustified reviews of past applications of NSR or second guessing past permit decisions will affect the ability to acquire new permits necessary to meet product demand and regulatory requirements.
- **Federal Pre-emption of Fuels Specifications** – Federally established fuel specifications will greatly simplify the manufacture and distribution of gasoline and other necessary petroleum products. Congress should pass legislation restricting states and localities from establishing separate fuel specifications. States and localities that are considering localized restrictive fuel requirements, such as lower sulfur and limitations on MTBE use, must recognize that these requirements will increase cost and reduce the reliability of product supplies. The existing distribution system is severely restricted by the multiple product grades required by state or locality specific fuels specifications. Cost/benefit analysis should include the cost and operational impacts on the distribution system when considering fuels specifications that do not conform to established parameters.

Attachment 2

**Reply to Representative Joe Barton of Texas' question on the difficulty in manufacturing Phase II Reformulated Blendstock for Oxygenate Blending (RBOB)**

During the summer of 2000, 12 different types of gasoline are required, east of the Rockies. Each of these types of gasoline is available in three octane grades. Each of these 36 gasolines is a blend of several unique streams produced in the refinery process. Therefore, in order to meet the specifications of each gasoline a particular ratio of these streams must be carefully blended in order to produce finished gasoline that meets the specification for that particular grade.

The situation is further complicated in the Midwest, for two reasons, both of which arise from the fact that the primary oxygenate used in the blend is ethanol rather than MTBE.

**(1) Ethanol's Affinity for Water** - Ethanol has a high affinity for water so special precautions must be taken to ensure that the gasoline/ethanol blend does not come in contact with water. As a result, a special product manufactured at the refinery called Reformulated Blendstock for Oxygenate Blending, or RBOB is shipped to the product distribution terminal. Ethanol is then added to the RBOB at the terminal. This requires separate tankage, blending equipment, permitting, etc. for two products (RBOB and ethanol) rather than one.

**(2) Ethanol's Higher Volatility** - Ethanol has a higher volatility (18 psi vs. 8 psi) than MTBE, making it much less attractive for gasoline blending, especially for summer RFG where low volatility is required. This means that the RBOB has to be made with an even lower volatility in order to compensate for the ethanol. The VOC standard in Phase II of the Complex Model is the primary hurdle refiners' face when manufacturing reformulated gasoline (RFG). The complex interactions between the 8 fuel parameters used in the Complex Model for calculating VOC emission reductions are raised to a new level for Phase II blending compared to Phase I. Complex Model Phase II VOC controlled gasoline represents the lowest volatility group of product the refining industry has ever had to produce. Because of the relatively high volatility of ethanol, refiners must produce RBOB with a Reid Vapor Pressure (RVP) of approximately 5.3 - 5.6 psi. This represents a reduction of 0.7 - 0.9 psi versus the Phase I RBOB that has been produced in year's past. In a typical refinery, the RVP of a majority of the blending components have historically exceeded this level.

The decision to produce RBOB in the Phase II RFG Program is not just based on economics, but feasibility of meeting the specifications. Refiners had to find new ways to reduce the overall RVP of the gasoline blending pool to meet Phase II requirements, but particularly with the components used to blend RBOB due to the higher vapor pressure ethanol.

Attachment 3

**Reply to Representative Thomas Barrett of Wisconsin's comment on the failure of the EPA, DOE, or the oil industry to warn Congress that there could be supply disruptions with introduction of Phase II RFG gasoline.**

The oil industry did express concerns to the EPA that converting from Phase II RFG winter gasoline to Phase II RFG summer gasoline would be a challenge to refiners since inventories would have to be pulled down to near empty levels to convert tanks in the refinery, terminals, and at retail outlets. These concerns were voiced repeatedly during Phase II implementation meetings with the EPA, but the EPA chose to ignore these warnings and they were never included in the minutes to the meetings. The DOE is also on record that supply problems were a concern.

I am very concerned that the EPA is, again, not listening to the warnings of the oil industry as to the potential for inadequate supplies of products resulting from their recent Tier 2 gasoline regulations and their proposed diesel sulfur regulations. Unless the EPA changes its approach I expect to see many future disruptions in supply with resultant price increases.

Meeting Tier 2 gasoline regulations will be expensive, about \$8 billion for the industry, and will present a significant challenge to refiners. There are a number of factors that could have implications on supply. Because of the high capital costs, it is likely that some refiners will be unable to justify the investments, and will simply shut down. Most others, because of the high cost of conventional desulfurization technology, will use new and unproven technologies to reduce the sulfur content of gasoline. These new technologies, while being less costly, will have limited commercial experience and will likely result in more initial operating problems and increase the risk for supply disruptions. In order to meet the deadline of 2004-06 required by the EPA, the industry will face significant hurdles to obtain the necessary permits, engineering and construction resources, and hardware to complete the work on time. If the EPA does not properly facilitate the permitting process or if other regulations, like the proposed diesel sulfur regulations or a ban on MTBE, overlap the Tier 2 work, then we are on a course for disaster. Gasoline supply disruptions could be experienced for long periods of time, leading to fundamentally higher prices at the pump.

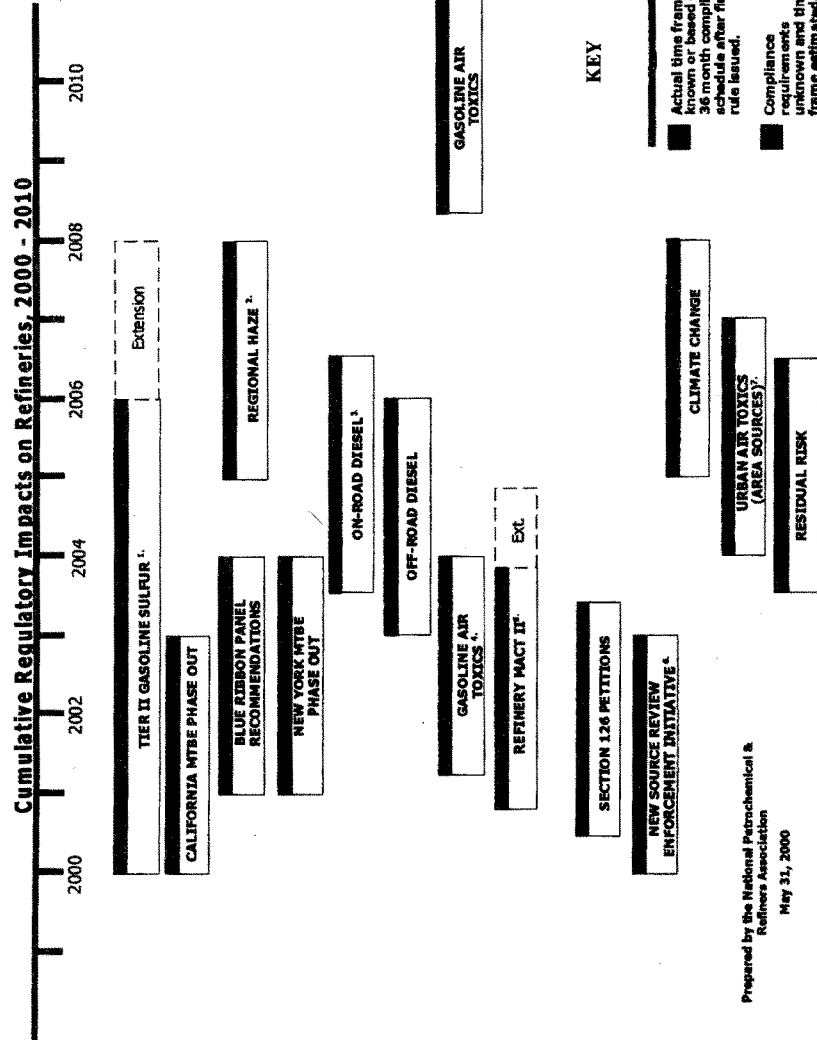
I am deeply concerned about the EPA's proposed diesel fuel sulfur rule. I have strong doubts that it will be possible to consistently maintain needed supplies of on-highway diesel within the 15 ppm sulfur level cap proposed in this rule. With the current distribution system, it will be extremely difficult to deliver on-highway diesel with a 15 ppm cap to consumers and maintain the integrity of the sulfur level of the product. This highway diesel must share a distribution system with other products that have significantly higher sulfur levels. At the proposed 15 ppm sulfur level, a significant amount of on-highway diesel will have to be downgraded to a higher sulfur product due to product contamination at the pipeline interfaces, where different product batches in the pipeline mix together. This will require refiners to produce significantly more on-highway diesel than the volumes required by consumer demand. I believe that due to the high cost to produce 15 ppm sulfur diesel, many refiners will choose not to participate in the on-highway diesel market or will limit their participation to less than today. Some



will be forced to simply go out of business. This could drastically reduce the supplies of on-highway diesel and supply disruptions and price spikes could well be the norm. If this turns out to be the case, prices will rise which will encourage refiners to invest in additional desulfurization equipment. Unfortunately, it will be four years before this new equipment can be permitted, designed, and constructed to deliver more supply to the market.

The sulfur level for on-highway diesel being proposed by the EPA is too low and the timing is too soon. Similar benefits can be obtained from a more reasonable 50 ppm sulfur cap. The EPA arbitrarily selected the NO<sub>x</sub> tail pipe emission standards for the proposed diesel sulfur without the technology to support the standard. The engine manufacturers do not have the after treatment technology today to meet the standard and the oil industry does not have the desulfurization technology to reduce sulfur to the levels being required by proposal in a cost-effective manner.

I sincerely hope that the concerns that I have expressed will serve as a warning, and that the appropriate action is taken to ensure that this nation does not face a protracted period of product outages and volatile prices. I believe, if government and industry work together to implement sound regulations, this nation can have both clean air and adequate supplies of clean fuels.



J.L. Frank  
President




---

**MARATHON ASHLAND Petroleum LLC**

539 South Main Street  
Findlay, OH 45840-3295  
Telephone 419/422-2121

July 13, 2000

The Honorable Thomas J. Bliley  
Chairman  
House Committee on Commerce  
2125 Rayburn House Office Building  
Washington, DC 20515

Dear Mr. Chairman:

Thank you for the opportunity to address the Commerce Committee during your hearing on the "Summer Energy Concerns for the American Consumer" on June 28, 2000. It was my pleasure to represent Marathon Ashland Petroleum (MAP) and to have the opportunity to describe our efforts to meet the transportation fuel needs of our customers.

While testifying, I was asked the following question: "What can the Administration do in regard to the transportation fuels crisis?" I have summarized below what we view as the most significant areas of concern and have provided recommendations which we believe will best enable our industry to prospectively avoid the imbalances in supply and demand that have occurred in the past few weeks.

In most instances we have identified steps that could be taken by the US EPA with a request for Congressional oversight or encouragement. In others, we make direct suggestions for specific, targeted legislative action. I have also attached supplemental exhibits, which I would ask to have included in the public record along with this letter as addenda to my previously submitted testimony. Individuals copied on this correspondence will be receiving only the four exhibits directly cited in this letter.

**Transportation Fuel Supply**

The nation's growing demand for transportation fuels can be met only through the utilization of adequate and efficient domestic refining and transportation infrastructure and through access to sufficient supplies of crude oil. All of these elements have been and continue to be under attack.

Specifically, fifty of our nation's refineries, 12 in the Midwest alone, have closed in the last decade due to poor profitability and costly, burdensome environmental regulations. (Exhibit VI) Continued expansion of the Clean Air Act Amendments of 1990 by overly broad implementation, such as the recent Tier 2 gasoline sulfur requirements and EPA's current proposal for drastic reductions in diesel sulfur, will place even greater burdens on refineries, resulting in even more shutdowns. Additional Congressional oversight may help curtail this overzealous and ill-advised regulatory trend.

The Honorable Thomas J. Bliley  
 July 13, 2000  
 Page 2

Further, both this country's refineries and its fuel transportation infrastructure are operating at near capacity levels. This is especially true in the Midwest. Therefore, any significant disturbance in refinery or pipeline operation will lead to shortages in the supply of fuel. Unfortunately, we find that our efforts to add capacity, by building new or expanding existing refinery units or pipelines, face an uphill battle against excessive litigation and regulation.

We would urge Congress to undertake all efforts possible to alleviate these types of roadblocks. A specific example would be legislation to prohibit EPA from finalizing its proposed New Source Review rule until the agency has truly listened to the practical implications for our industry of what it is proposing.

Finally, much of our nation's wealth of natural resources in the form of crude oil reserves have been designated off-limit through legislation, forcing greater dependence on imported crude oil. Until Congress rethinks these policies on domestic exploration this dependence will continue to grow.

#### **Strengthening Our Nation's RM&T Infrastructure**

In order to ensure the vitality of the nation's refining, marketing and transportation (RM&T) capability, return on investment for those assets must be improved. Significant future capital investment will clearly be required for both refineries and terminals in order to meet stationary source and fuel specification needs. Likewise, increased capital investment will be required to maintain and increase the capability of the petroleum pipeline transportation network.

For companies to choose to make these investments and to attract sufficient funding from the capital markets competitive returns must be projected. Brief or isolated periods of heightened returns such as we have experienced recently on these RM&T assets are not sufficient to attract this investment.

Our reality is that returns for the refining and marketing industry during the last decade have been dismal. While the financial performance of the companies comprising the S&P 500 achieved 17.4% total market return on capital over the past 10 years, the refining and marketing sector returned only 5.4% over the same period. (Exhibit XXIV) Clearly, if we are forced to employ a cost of capital at 9 or 10 percent, but we earn a return of only 5 to 6 percent, our industry is being systematically liquidated.

During the past decade, more than \$43 billion has been invested in the refining and marketing industry according to the National Petroleum Council Study which was dated June 20, 2000. Almost half of this investment has been for environmental projects required by the Clean Air Act Amendments of 1990. (Exhibit I) Over the next six years, our industry will be faced with capital investments for the Tier 2 gasoline sulfur reduction requirements, low-sulfur diesel requirements, possible additional oxygenate mandates and the potential for significantly more stringent drivability index (DI) requirements.

The same NPC study estimates the total investment in these new fuel specifications alone to be \$13 to \$36 billion, depending on changes in proposed rules or legislative alternatives. These capital expenditures for mandated new fuel specifications will further reduce profitability and reinvestment alternatives for the industry. It is hard to understand why many companies would

he Honorable Thomas J. Bliley  
July 13, 2000  
Page 3

oose to make such large investments when faced with the probability of continued low rates of  
turn on capital invested.

What can Congress do? Let the market work. Capital will flow to fund these much needed  
infrastructure improvements if market mechanisms are free to reward those investments.

Our industry needs advocates in the legislative branch to help us put a halt to the onslaught of  
regulatory actions being taken by the administration with little or no regard for the resulting negative  
impact on the refining, marketing and supply sectors of our industry.

Anything that can be done by way of oversight hearings or legislative restrictions on further  
rulemaking could make a significant difference. Moreover, the enactment of legislation designed to  
control or restrict actions of the market place can seriously limit the ability of our industry to respond  
in a timely and efficient manner to supply/demand dynamics.

#### Policy On Fuel Requirements

We fully support the development of cost effective fuel regulations which can be justified on  
sound scientific principles and which meet a demonstrated environmental need. We oppose  
regulations which do not meet these basic principles for fear that any unnecessary expenditures will  
drain needed capital, which could be more beneficially applied to increase capacity and improve  
flexibility. Below is our outline for much needed changes to EPA's current fuels agenda:

##### **Gasoline**

The Tier 2 gasoline sulfur regulations have been finalized. While we believe that these  
regulations are not cost effective and will produce minimal measurable environmental benefit, we are  
working on plans to implement the new rule and to maximize the use of sulfur credits internally. EPA  
still has not developed a proposal to deal with turnarounds and unscheduled shutdowns and has not  
responded to industry proposals to address these issues. Further, the agency has not dealt  
satisfactorily with issues surrounding the large number of permits that will be required. If anything, we  
expect that both the number of permits to be handled and the time required for each permit will  
increase vastly if the agency promulgates a final New Source Review rule later this year.

##### **Diesel**

We strongly oppose EPA's proposal of a 15 ppm sulfur cap for highway diesel fuel. Meeting  
the national demand for this fuel will be very difficult for most refiners and nearly impossible for many.  
The refining and distribution systems of this country will continuously face the peril of noncompliance  
fuel unavailability as the result of virtually any minor disruption or mechanical problem so long as  
we are forced to make this ultra-low sulfur diesel.

Additionally, it will be nearly impossible to protect this ultra-low sulfur diesel from  
contamination in the distribution system. We believe that the resulting supply and demand  
imbalances have the potential to create price and supply disruptions that can dwarf the recent  
gasoline disruptions in the Midwest.

The Honorable Thomas J. Bliley  
 July 13, 2000  
 Page 4

EPA has developed its proposal based on very few facts and a lot of wishful thinking. Notwithstanding numerous unanswered questions concerning our ability to manufacture and distribute this ultra-low sulfur fuel and the ability of the engine manufacturers to develop effective emissions control technology, EPA appears committed to finalizing this rule by the end of the year. We would urge Congress to encourage EPA to accept our industry's proposal of a 50 ppm sulfur cap with a 30 ppm average or to impose a legislative delay on the rulemaking until all significant, unanswered questions have been addressed.

In addition, regardless of whether the new highway diesel sulfur level is ultimately set at 50 or 15 ppm, the magnitude of the design and construction efforts that will be required is staggering. The Tier 2 gasoline requirements alone will mandate the construction of new desulfurization units at nearly all US refineries outside of California. To the extent the lower sulfur diesel requirements can be implemented on a delayed timeline, the more likely it will be that we can achieve both gasoline and diesel desulfurization in this country without unprecedented supply disruptions and shortages of both products.

#### **Oxygenates**

We support a measured phase down of MTBE in gasoline, provided such a phase down is coupled with elimination of the existing oxygenate requirement. However, we oppose any new statutory provisions which would replace the existing oxygenate requirement with an ethanol or renewable or alternative fuels mandate either for RFG areas or for the total gasoline pool.

We do not oppose the use of ethanol. In fact, our company is the nation's largest purchaser and blender of fuel ethanol. (Exhibit XVII) We simply believe that government mandates are not a good idea. Historically these types of mandates have proven to be cost inefficient and result in unwarranted market interference.

#### **Air Toxics**

Fuel air toxics and benzene reduction regulations are currently being developed by EPA. We believe that the agency has already discharged its duty under the Clean Air Act Amendments of 1990 to control both air toxics and benzene levels. EPA's own support documents indicate that massive toxic and benzene reductions are already scheduled to occur as part of the Tier 2 rule. This, coupled with the large particulate matter reductions targeted for the proposed highway diesel fleet, make further air toxic or benzene reductions unjustifiable. Whatever steps Congress can take to prevent EPA from proposing and finalizing these additional regulations for fuel air toxics and benzene reductions will prevent imposition of an additional, unnecessary burden on our industry.

#### **Environmental Permitting—Impact on RM&T**

Permitting delays for new processes, controls, tanks, pipelines and service stations can be very costly and time consuming. Sources of these delays are numerous, but one pertinent example is the pressure the state or local permitting authorities feel from EPA to meet the agency's deadline for issuance of Title V permits.

In order to attempt to meet this schedule, many of these permitting authorities simply put construction permits on hold until their Title V permits have been issued. Any encouragement from

The Honorable Thomas J. Bliley  
 July 13, 2000  
 Page 5

Congress for the EPA to work with these state and local authorities to ensure that permit applications for modifications or new construction to comply with new regulations do not fall behind Title V permits would be helpful.

Summary

In closing, we at Marathon Ashland Petroleum are proud of our response to the recent gasoline supply disruptions in the Midwest. To meet our commitments to our customers, we ran our refineries at near maximum capacity and took other extraordinary measures to move product into the affected markets.

But, the story is not over. We believe that this recent experience foretells future similar transportation fuel supply disruptions, some perhaps even more severe and widespread than those experienced recently in the Midwest. It is our belief that decades of under-investment in our nation's retail, marketing and transportation infrastructures have resulted in the inability of these remaining assets to supply the growing energy needs of a robust American economy.

The reasons for this chronic under-investment are complex, but they can generally be attributed to a pattern of large capital requirements for environmental projects occurring during an extended period of very poor financial returns. The net result is the inability of an entire industry to attract adequate capital to maintain an infrastructure that is sufficiently capable and flexible to respond appropriately to the unforeseen outages or upsets that inevitably occur in the system.

We urge you and the other members of Congress to take all possible legislative steps to increase the viability of our industry and to encourage the EPA and other agencies and departments within the administration to acknowledge the need to enhance our nation's refining, marketing and transportation infrastructure and to work toward removing all significant barriers to our achieving this important goal.

I would welcome the opportunity to discuss our specific ideas with you, other members of Congress, and with representatives of the administration.

Yours very truly,



Attachments

The Honorable Thomas J. Billey  
 July 13, 2000  
 Page 6

cc:	The Honorable W.J. "Billy" Tauzin The Honorable Michael G. Oxley The Honorable Michael Bilirakis The Honorable Joe Barton The Honorable Fred Upton The Honorable Cliff Stearns The Honorable Paul E. Gillmor The Honorable Jim Greenwood The Honorable Christopher Cox The Honorable Nathan Deal The Honorable Steve Largent The Honorable Richard Burr The Honorable Brian Bilbray The Honorable Ed Whitfield The Honorable Greg Ganske The Honorable Charlie Norwood The Honorable Tom Coburn The Honorable Rick A. Lazio The Honorable Barbara Cubin The Honorable James E. Rogan The Honorable John M. Shimkus The Honorable Heather Wilson The Honorable John Shadegg The Honorable Charles W. "Chip" Pickering, Jr. The Honorable Vito J. Fossella The Honorable Roy Blunt The Honorable Ed Bryant The Honorable Robert L. Ehrlich, Jr. The Honorable J. Dennis Hastert The Honorable Richard A. Gephardt The Honorable Bill Richardson The Honorable Carol M. Browner Patricia M. Richards USX Corporation	The Honorable John D. Dingell The Honorable Henry A. Waxman The Honorable Edward J. Markey The Honorable Ralph M. Hall The Honorable Rick Boucher The Honorable Edolphus Towns The Honorable Frank Pallone, Jr. The Honorable Sherrod Brown The Honorable Bart Gordon The Honorable Peter Deutch The Honorable Bobby L. Rush The Honorable Anna G. Eshoo The Honorable Ron Klink The Honorable Bart Stupack The Honorable Eliot L. Engel The Honorable Thomas C. Sawyer The Honorable Albert R. Wynn The Honorable Gene Green The Honorable Karen McCarthy The Honorable Ted Strickland The Honorable Diana DeGette The Honorable Thomas M. Barrett The Honorable Bill Luther The Honorable Lois Capps
-----	--	---



Addendum to Testimony of J. Louis Frank  
President, Marathon Ashland Petroleum LLC ("MAP")  
Before the Committee on Commerce  
U.S. House of Representatives

June 28, 2000

Exhibits:

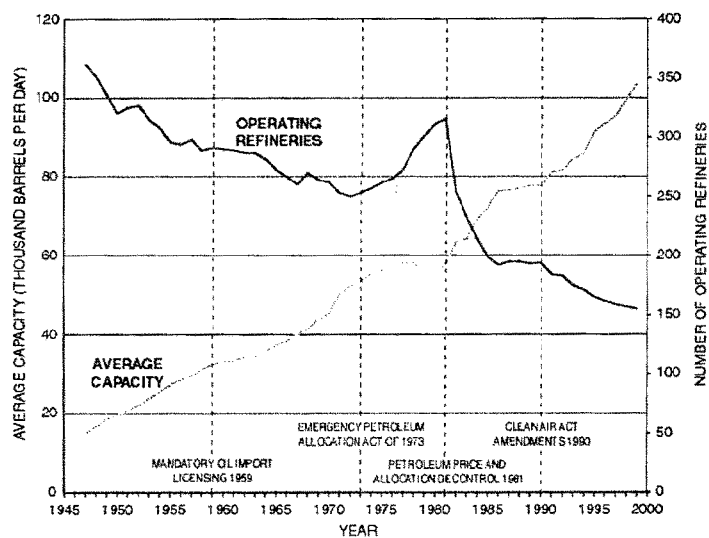
- I. National Petroleum Council (NPC) draft report, "U.S. Petroleum Refining--Assuring the Adequacy and Affordability of Cleaner Fuels", June 20, 2000.
  - Operating Refineries vs. Average Capacity
  - Refining and Marketing Investments
  - Refining and Marketing Return On Equity vs. S&P 500
- II. State/Federal Gasoline Excise Taxes (MAP)
- III. U.S. Refinery Capacity (DOE/EIA, 1999 Petroleum Supply Annual)
- IV. U.S. Refinery Capacity Utilization (DOE/EIA, 1999 Petroleum Supply Annual)
- V. MAP Refinery Capacity Utilization (MAP)
- VI. U.S. Refinery Closures (July 1999, API, Basic Petroleum Data Book)
- VII. "Midwest Gasoline Price Increases", CRS Report, June 16, 2000
- VIII. Why RFG Inventories Must be Taken to Near Zero Levels for Spring Conversion (MAP)
- IX. J L. Frank Letter to the Editors; The Courier, The Cincinnati Post, and The Detroit News, June 2000
- X. Chicago Market Wholesale Gasoline Price Chart (Source: Platts)
- XI. PADD2 Conventional Gasoline Inventories (Source: API, "Weekly Bulletin")
- XII. NYMEX Crude Oil and NYMEX Gasoline Prices (New York Mercantile Exchange)
- XIII. Components of the Pump Price of Gasoline (API, Consumer Information Report: "Profits are Small Part of the Pump Price for Gasoline", April 14, 2000)
- XIV. Regional Fuels Supply Map (MAP)
- XV. MAP Refining Gasoline Production Comparison (MAP)

- XVI. Energy Information Administration, "Update: A Year of Volatility- Oil Markets and Gasoline", June 20, 2000
- XVII. U. S. Ethanol Production and MAP Purchases (DOE/EIA, Renewable Fuels Association and MAP data)
- XVIII. CRS Report, "Environmental Protection Agency Options for Ameliorating the Effects of Reformulated Gas Requirements in the Chicago/Milwaukee Area", June 28, 2000.
- XIX. PIRINC Study, "Gasoline101: A Politically Explosive Topic", June 2000
- XX. "Energy Overview: Are Oil Companies Gouging Consumers?" by Fadel Gheit, Fahnestock & Company, June 21, 2000.
- XXI. "Who's to Blame?", Business Week, July 3, 2000
- XXII. J. L. Frank Testimony on Diesel Sulfur, EPA Public Hearing, June 19, 2000, New York
- XXIII. J. L. Frank letter to EPA on Diesel Sulfur, June 23, 2000
- XXIV. Segment Returns in Refining and Marketing (Source: DOE/EIA: Performance Profiles of Major Energy Producers)
- XXV. A Primer on Gasoline Prices (EIA pamphlet, [www.eia.doc.gov](http://www.eia.doc.gov))
- XXVI. CATO Institute Testimony, House Committee on Government Reform, "The Effect of Federal Regulations on Gasoline Prices in the Milwaukee/Chicago Area", July 7, 2000.
- XXVII. EPA Office of Mobile Sources Fact Sheet on RFG, November, 1999

**EXHIBIT I****National Petroleum Council (NPC) draft report, "U.S. Petroleum Refining--Assuring the Adequacy and Affordability of Cleaner Fuels", June 20, 2000.**

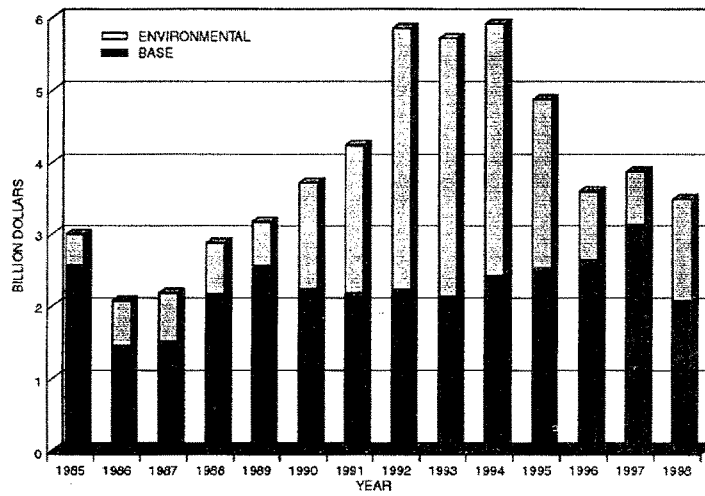
The following exhibits were taken from the June 20, 2000 draft release of the National Petroleum Council's report "U. S. Petroleum Refining – Assuring the Adequacy and Affordability of Cleaner Fuels":

- **Operating Refineries vs. Average Capacity**  
Since the oil industry was decontrolled in 1982, there has been a clear trend toward fewer and larger operating refineries. Companies have chosen to close smaller and presumably less efficient plants, while larger and more sophisticated refineries have been expanded. Some industry analysts cite the increased capital requirements for the manufacture of clean fuels as a contributor to this trend. Currently there are 155 operating refineries with 16.3 million barrels per day of crude oil distillation capacity. The average refinery has a capacity of 105,000 barrels per day.
- **Refining and Marketing Investments**  
The U. S. refining and marketing industry (R & M) has invested heavily for both the maintenance and expansion of facilities and for the environment. According to data collected by the Department of Commerce and API, base R&M expenditures average around \$2 billion per year while environmental expenditures vary from a few hundred million to as much as \$4 billion per year. Environmental expenditures were at very high level in 1992 through 1995 in response to the Clean Air Act Amendments of 1990 and other clean fuel programs.
- **Refining and Marketing Return on Equity vs. S&P 500**  
The U. S. Petroleum industry has historically earned a lower rate of return on equity than the Standard & Poor 500 companies, 10.5% versus 12.5% as measured by the Energy Information Administration's (EIA) Financial Reporting System from 1981-1998. Within the petroleum industry, refining and marketing operations earn around a 5% return on capital employed versus 7% for the combined upstream and downstream segments.



Source: Data from API Basic Petroleum Data Book and EIA.

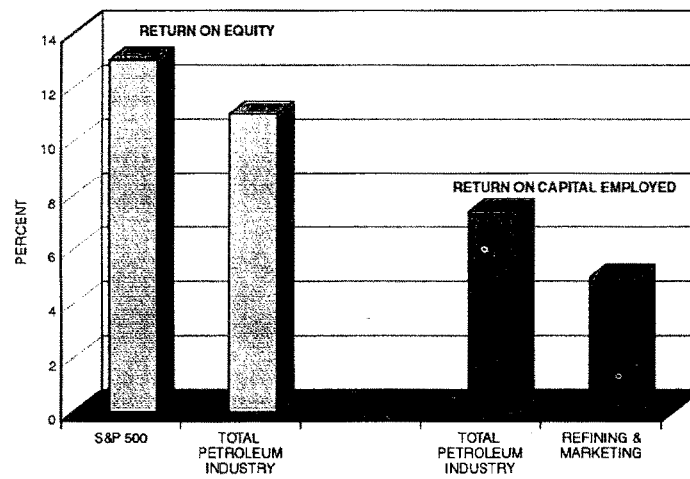
Figure 2. Average Capacity and Number of U.S. Operating Refineries



Source: Data for Total from Oil & Gas Journal.

Data for Environmental from API Reported Refining & Marketing Capital Investments 1990-1998; and Pre-1990 estimate from Department of Commerce.

Figure 4. Historical U.S. Refining and Marketing Investments



Source: Data from EIA's Financial Reporting System.

Figure 3. U.S. Refining and Marketing Return Comparison  
1981-1998 Average

**EXHIBIT II****State/Federal Gasoline Excise Taxes (MAP)**

When examining the difference between the wholesale or dealer tank-wagon price of gasoline and the average retail or "street" price, it is important to consider both the Federal and State excise taxes. In the Midwest states where MAP markets most of its gasoline, state excise taxes range from 15.0 to 26.4 cents per gallon to go along with the 18.4 cents per gallon federal excise tax. The attachment depicts the level of excise taxes in all 50 states as of June 30, 2000. Many states and municipalities also have sales taxes on gasoline in addition to these excise taxes.

**Federal and State Transportation Fuel Excise Taxes as of June 30, 2000**

	Gasoline (cents/gal)	Diesel (cents/gal)
<b>Federal Transportation Fuel Taxes</b>	18.4	24.4
<b>State Transportation Fuel Taxes</b>		
Alaska	8.0	8.0
Alabama	16.0	17.0
Arkansas	18.5	18.5
Arizona	18.0	18.0
California	18.0	18.0
Colorado	22.0	20.5
Connecticut	39.0	18.0
District of Columbia	20.0	20.0
Delaware	23.0	22.0
Florida	13.3	13.3
Georgia	7.5	7.5
Hawaii	16.0	16.0
Iowa	20.0	22.5
Idaho	25.0	25.0
Illinois	19.0	21.5
Indiana	15.0	16.0
Kansas	20.0	22.0
Kentucky	15.0	12.0
Louisiana	20.0	20.0
Massachusetts	21.0	21.0
Maryland	23.5	24.5
Maine	19.0	20.0
Michigan	19.0	15.0
Minnesota	20.0	20.0
Missouri	17.0	14.0
Mississippi	18.0	18.0
Montana	27.0	27.0
North Carolina	23.1	23.1
North Dakota	21.0	21.0
Nebraska	23.9	23.9
New Hampshire	18.0	18.0
New Jersey	10.5	13.5
New Mexico	17.0	18.0
Nevada	24.0	27.0
New York	8.0	8.0
Ohio	22.0	22.0
Oklahoma	16.0	13.0
Oregon	26.0	26.0
Pennsylvania	12.0	12.0
Rhode Island	28.0	28.0
South Carolina	16.0	16.0
South Dakota	22.0	22.0
Tennessee	20.0	17.0
Texas	20.0	20.0
Utah	19.0	19.0
Virginia	17.5	16.0
Vermont	19.0	16.0
Washington	23.0	23.0
Wisconsin	26.4	26.4
West Virginia	20.5	20.5
Wyoming	11.0	11.0



**EXHIBIT III****U.S. Refinery Capacity (DOE/EIA, 1999 Petroleum Supply Annual)**

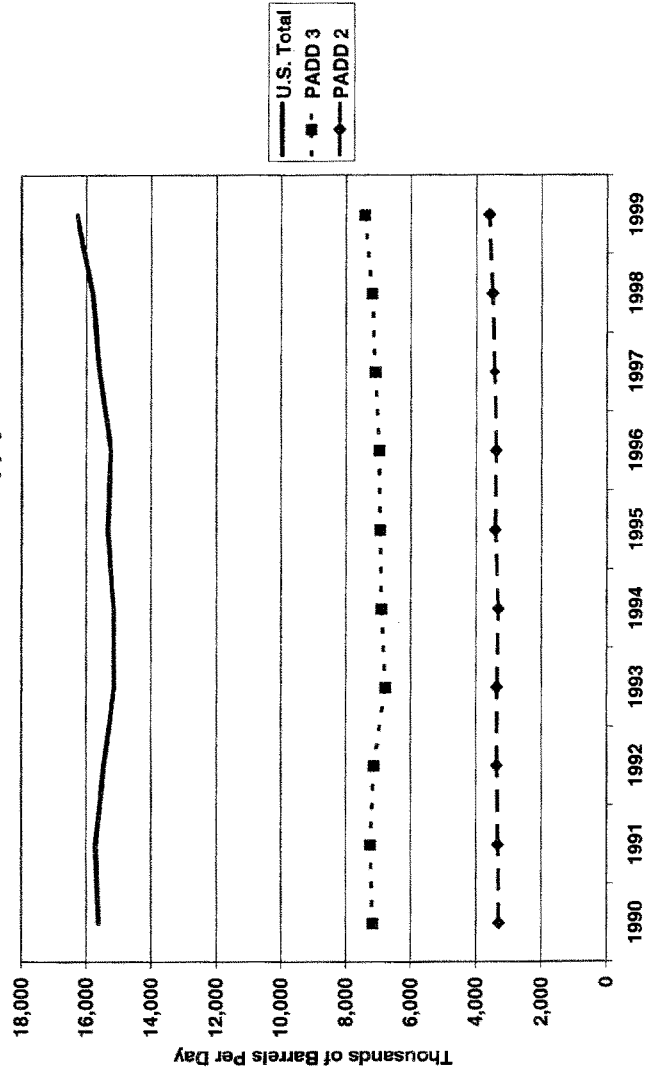
Total U. S. Refining capacity, measured as crude oil distillation capacity on January 1, 2000, is 16,511,871 barrels per day in 158 operable refineries. (Source: Energy Information Administration 1999 Petroleum Supply Annual) The total industry capacity has declined some from 1991 through 1996, but has been growing over the last four years. Refining capacity in the Midwest, generally referred to as PADD 2, has been relatively stable at 3.6 million barrels per day. The much larger Gulf Coast region (PADD 3) with 7.55 million barrels per day of capacity has been growing for the last several years.

Table 36. Number and Capacity of Operable Petroleum Refineries by PAD District and State as of January 1, 2000

PAD District and State	Number of Operable Refineries			Atmospheric Crude Oil Distillation Capacity					
				Barrels per Calendar Day			Barrels per Stream Day		
	Total	Operating	Idle <sup>a</sup>	Total	Operating	Idle	Total	Operating	Idle
<b>PAD District I</b>	<b>17</b>	<b>16</b>	<b>1</b>	<b>1,704,000</b>	<b>1,810,000</b>	<b>94,000</b>	<b>1,792,958</b>	<b>1,683,558</b>	<b>99,000</b>
Delaware	1	1	0	157,000	157,000	0	180,000	180,000	0
Georgia	2	2	0	33,400	19,400	14,000	40,000	24,000	16,000
New Jersey	6	5	1	668,000	588,000	80,000	693,158	610,158	83,000
Pennsylvania	6	6	0	772,800	772,800	0	824,400	824,400	0
Virginia	1	1	0	59,500	59,500	0	61,900	61,900	0
West Virginia	1	1	0	13,300	13,300	0	13,500	13,500	0
<b>PAD District II</b>	<b>28</b>	<b>28</b>	<b>0</b>	<b>3,819,404</b>	<b>3,619,404</b>	<b>0</b>	<b>3,791,100</b>	<b>3,791,100</b>	<b>0</b>
Illinois	6	6	0	1,029,515	1,029,515	0	1,079,000	1,079,000	0
Indiana	2	2	0	433,000	433,000	0	456,000	456,000	0
Kansas	3	3	0	294,400	294,400	0	306,000	306,000	0
Kentucky	2	2	0	227,500	227,500	0	236,300	236,300	0
Michigan	1	1	0	74,000	74,000	0	75,000	75,000	0
Minnesota	2	2	0	330,000	330,000	0	355,000	355,000	0
North Dakota	1	1	0	58,000	58,000	0	60,000	60,000	0
Ohio	4	4	0	525,500	525,500	0	539,000	539,000	0
Oklahoma	5	5	0	454,489	454,489	0	480,500	480,500	0
Tennessee	1	1	0	160,000	160,000	0	169,300	169,300	0
Wisconsin	1	1	0	33,000	33,000	0	35,000	35,000	0
<b>PAD District III</b>	<b>57</b>	<b>56</b>	<b>1</b>	<b>7,552,942</b>	<b>7,546,242</b>	<b>6,700</b>	<b>7,984,312</b>	<b>7,977,512</b>	<b>7,000</b>
Alabama	3	3	0	130,000	130,000	0	138,000	138,000	0
Arkansas	3	2	1	66,912	60,212	6,700	68,750	61,750	7,000
Louisiana	17	17	0	2,676,580	2,676,580	0	2,804,255	2,804,255	0
Mississippi	4	4	0	335,800	335,800	0	384,000	384,000	0
New Mexico	3	3	0	95,600	95,600	0	100,107	100,107	0
Texas	27	27	0	4,246,050	4,246,050	0	4,489,200	4,489,200	0
<b>PAD District IV</b>	<b>16</b>	<b>15</b>	<b>1</b>	<b>540,755</b>	<b>530,755</b>	<b>10,000</b>	<b>572,200</b>	<b>559,700</b>	<b>12,500</b>
Colorado	2	2	0	84,500	84,500	0	92,000	92,000	0
Montana	4	4	0	162,090	162,090	0	167,700	167,700	0
Utah	5	4	1	162,000	152,000	10,000	172,500	160,000	12,500
Wyoming	5	5	0	132,165	132,165	0	140,000	140,000	0
<b>PAD District V</b>	<b>40</b>	<b>40</b>	<b>0</b>	<b>3,094,770</b>	<b>3,008,570</b>	<b>86,200</b>	<b>3,252,500</b>	<b>3,157,700</b>	<b>94,800</b>
Alaska	6	6	0	359,550	359,550	0	383,000	383,000	0
California	23	23	0	1,982,000	1,905,000	77,000	2,082,400	1,997,500	84,800
Hawaii	2	2	0	147,500	147,500	0	152,000	152,000	0
Nevada	2	2	0	5,000	5,000	0	7,000	7,000	0
Oregon	1	1	0	0	0	0	0	0	0
Washington	6	6	0	600,720	591,520	9,200	628,100	618,100	10,000
<b>U.S. Total</b>	<b>158</b>	<b>155</b>	<b>3</b>	<b>16,511,871</b>	<b>16,314,971</b>	<b>196,900</b>	<b>17,383,070</b>	<b>17,179,770</b>	<b>213,300</b>
Puerto Rico	3	2	1	87,000	42,000	45,000	94,000	48,000	46,000
Virgin Islands	1	1	0	495,000	430,000	65,000	525,000	450,000	75,000

See footnotes at end of table.

U. S. Refinery Crude Oil Distillation Capacity  
DOE/EIA Petroleum Supply Annual



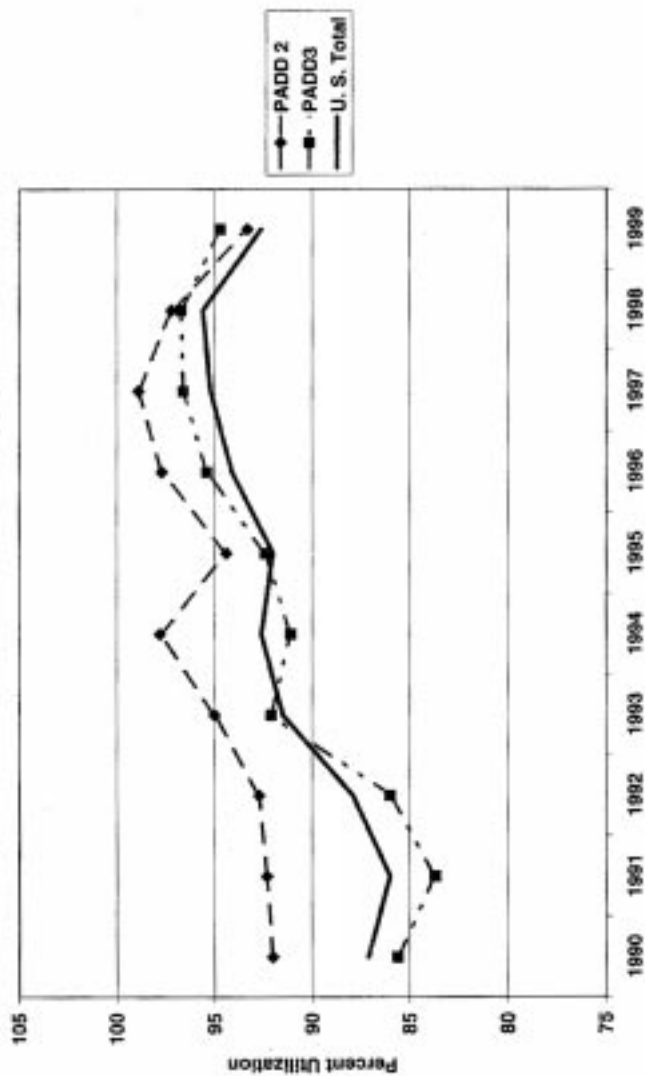
refcap utilization.xls

7/3/00

**EXHIBIT IV****U.S. Refinery Capacity Utilization (DOE/EIA, 1999 Petroleum Supply Annual)**

U. S. refining industry crude oil throughputs have utilized an ever-higher percentage of refining capacity over the decade of the nineties, increasing from around 87% to above 95%. Refinery utilization in PADD 2 has historically been measurably higher, at 92% to 98%. Over the last few years, utilization in PADD 3 and the U. S. as a whole has increased to about the same level, around 95%. When the large Gulf Coast district is at high utilization, there is less spare capacity and a reduced ability to make up for supply shortfalls in the Midwest.

**U. S. Refinery Crude Oil Distillation Capacity Utilization**  
Source: DOE/EIA Petroleum Supply Annual



refcap utilization.xls

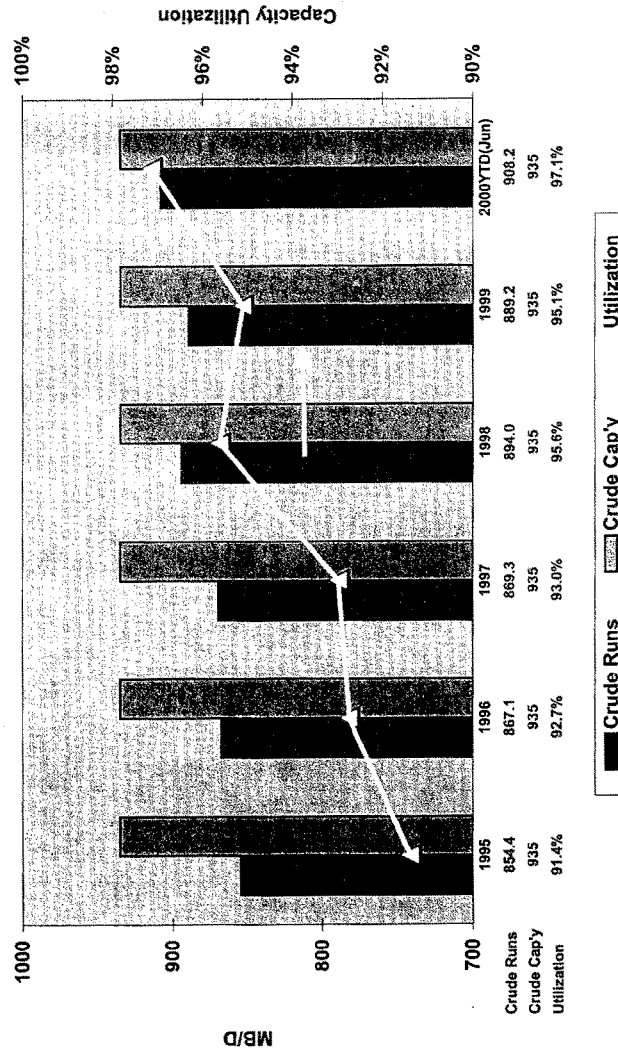
7/3/00

**EXHIBIT V**

**MAP Refinery Capacity Utilization (MAP)**

Marathon Ashland Petroleum (and its parent partners before 1998) have historically exceeded the national average utilization and have increased refinery utilization from 91% in 1995 up to 97% in 2000 year-to-date.

# MAP LLC Refinery Crude Oil Distillation Capacity and Utilization



crudecap.xls

7/7/00

**EXHIBIT VI****U.S. Refinery Closures (July 1999, API, Basic Petroleum Data Book)**

The changes in U. S. refining capacity has unfortunately involved the shutdown of a number of refineries in all parts of the country, as shown in the exhibit. In PADD 2, there have been 13 refinery closures with a combined capacity of 337,300 barrels per day of capacity since 1987. In the larger PADD 3, there have been 27 shutdowns totaling 819 thousand barrels per day. In the U. S. total closings have numbered 63 refineries with nearly 1.6 million barrels per day of capacity.



United States Refineries Inoperable Shutdown (1)  
as of January 1, 1987 through December 1, 1999

Refinery	Location	Crude Distillation Capacity (b/d)	Date of Last Operation	Date Shutdown	Years in Operation	PAD	Nelson Complexity Index (2)
Cibro Refining	Albany, NY	41,850	Jul-93	Sep-93	14+	1	
St. Mary's Refg. Co.	St. Mary's, WV	4,000	Feb-93	Mar-93	45+	1	
Seminole Refining Corp.	St. Marks, FL	17,000	May-87	Mar-88	28	1	
Virginia Oil & Refining Co., Inc.	Jonesville, VA	1,000	Aug-87	Dec-87	2	1	
Total PAD I		63,850		4			
Barrett Refg. Corp.	Custer, OK	10,500	Jan-96	Jan-96	15	2	1.0 A
Coastal Refg. & Mktg.	Augusta, KS	0	May-93	Jun-93	7	2	5.0 A
Coastal Refg. & Mktg.	Wichita, KS	43,700	May-93	Jun-93	45+	2	
Crystal Refining	Carson City, MI	3,000	Oct-92	Sep-93	45+	2	1.0 A
Cyrl Petrochemical Corp.	Cyrl, OK	7,500	May-95	Dec-95	2	2	
Farmiland Industries	Phillipsburg, KS	26,400	Dec-91	Jul-92	43+	2	3.2 A
Indian Refining	Lawrenceville, IL	80,750	Sep-95	Oct-95	6	2	9.0 A
Intercoastal Energy Services Corp.	Troy, IN	1,250	Nov-90	Mar-91	2	2	
Laketon Refining Co.	Laketon, IN	11,100	Jun-95	Jan-96	5	2	3.0 A
Marathon Oil Co.	Indianapolis, IN	50,000	Sep-93	Oct-93	45+	2	7.0 A
Motor Oils Refining	McCook, IL	1,500	Jan-88	Feb-88	6	2	
Total Petroleum, Inc.	Arkansas City, KS	55,000	Aug-96	Sep-96	4	2	6.6 A
UDS-Total	Alma, MI	45,600	Oct-99	Oct-99	n/a	2	7.9 B
Total PAD II		337,300		13			
Amerasia Hess	Purvis, MS	30,000	Jan-94	Feb-94	35+	3	
Arcadia Refg. & Mktg.	Lisbon, LA	7,350	Jan-96	Jun-96	13	3	
Canal Refining Co.	Church Point, LA	9,500	May-97	Jun-97	44+	3	1.7 B
Donna Refining Partners Ltd.	Donna, TX	4,750	Nov-89	Dec-89	1	3	
Dubach Gas	Dubach, CA	8,500	Dec-93	Dec-93	20	3	
Eagle Refining	Jackson, TX	1,600	Jan-90	Oct-90	6	3	
El Paso Refining, L.P.	El Paso, TX	50,000	Oct-92	Dec-92	6	3	
GAMXX Energy Inc.	Theodore, AL	27,000	Jan-88	Mar-88	17	3	
Gold Line Refg., Ltd.	Lake Charles, LA	27,600	May-97	Apr-97	17+	3	15.3 B
Gold Line Refg., Ltd.	Jennings, LA	12,000	Jul-97	Jan-98	1	3	
Intron Refg., Inc.	San Leon, TX	7,000	NA	Aug-90	0	3	
Liquid Energy Corp.	Bridgeport, TX	10,000	Feb-87	Oct-88	6	3	
Longview Refining Assoc.	Longview, TX	13,300	Aug-92	Sep-92	3	3	
MacMillan Petroleum Co.	Norphet, AR	5,800	Aug-87	Dec-87	39	3	
OGC Corp.	Egan, LA	5,000	Sep-87	Oct-88	2	3	
Pacific Refg.	Hercules, CA	50,000	Jul-95	Sep-97	29	3	
Petrolite Corp.	Kilgore, TX	600	Dec-97	Feb-98	45+	3	
Pride Refg. Inc.	Ablene, TX	42,750	May-98	Apr-99	37+	3	4.1 B
Rattessake Refining	Wickett, TX	8,000	Feb-92	Mar-92	2	3	
Sabine Resources	Stonewall, LA	12,000	(b)	Feb-92	0	3	
Shell Oil Co.	Odessa, TX	28,300	Oct-98	Nov-98	39+	3	4.3 B
Texas United Refining Corp.	Nixon, TX	20,900	Apr-92	Jun-92	17	3	
Thriftway Co.	Bloomfield, NM	4,000	Jan-92	Oct-92	5	3	
Trans-American Refining Corp. (3)	Norco, LA	300,000	(b)	Dec-92	0	3	
Unocal Corp.	Nederland, TX	120,000	Dec-89	Dec-89	6	3	
Vulcan Refining	Cordova, AL	9,500	Sep-90	Dec-90	6	3	
Warrior Asphalt Refining Corp.	Holt, AL	4,000	Aug-89	Dec-89	34	3	
Total PAD III		819,650		27			
Amoco Oil Co.	Casper, WY	40,000	Dec-91	Dec-91	6	4	
Landmark Petroleum Inc.	Fruita, CO	10,000	Jan-92	Nov-93	3+	4	
Mountaineer Refining Co., Inc.	LaBarge, WY	350	Dec-87	Jun-88	13	4	
Pennzoil Producing Co.	Roosevelt, UT	8,000	Sep-94	Oct-94	20+	4	
Total PAD IV		58,350		4			
Anchor Refining Co.	McKittrick, CA	10,000	Jun-91	Aug-91	5	5	
Bescon Oil Co.	Hanford, CA	17,300	Nov-87	Dec-87	27	5	
Chemolt Reg. Corp.	Long Beach, CA	18,000	Feb-94	Apr-94	5+	5	
Chevron	Kensai, AK	22,000	Jun-91	Jul-91	7	5	
Eco Asphalt Inc.	Long Beach, CA	10,550	(b)	Oct-92	0	5	
Fletcher Oil & Refining	Carson, CA	28,675	Sep-92	Oct-92	44+	5	
Gibson Oil & Refining	Bakersfield, CA	9,600	Jul-87	Dec-90	5	5	
Golden West	Santa Fe Springs, CA	47,000	Feb-92	Mar-92	9	5	

United States Refineries Inoperable Shutdown (1)  
as of January 1, 1987 through December 1, 1999

Refinery	Location	Crude Distillation Capacity (bbl)	Date of Last Operation	Date Shutdown	Years in Operation	PAD	Nelson Complexity Index (2)
Intermountain Refining Co.	Fredonia, AZ	3,800	Jan-94	May-96	1+	5	1.5 B
Newhall Refining Co., Inc.	Newhall, CA	22,500	Nov-89	Dec-89	42	5	
Petro Source Refining	Tonopah, NV	4,500	Sep-91	Dec-92	21	5	
Powerline Oil Co.	Santa Fe Springs, CA	46,500	Jun-95	Sep-95	8+	5	
Sound Refining Inc.	Tacoma, WA	40,000	Oct-98	Dec-98	30+	5	1.8 B
Sunbelt Refining Co.	Coolidge, AZ	10,000	Aug-93	Sep-93	3+	5	
Sunland Refining Corp.	Bakersfield, CA	12,000	Mar-95	Dec-95	47+	5	1.7 B
Total PAD V / No. of refineries		303,425					
Total U.S./ No. of refineries		1,582,675	63				

(1) The July 1999, API, Basic Petroleum Data Book, included data through 12/98, Alma was added for 1999.

(2) A - 1992 Marathon Economics study - calculated

B - 1996 Lehman Brothers publication

## EXHIBIT VII

**"Midwest Gasoline Price Increases", CRS Report, June 16, 2000**

The Congressional Research Service report on the causes for high gasoline prices in Midwestern states attributes the price increases to five factors: 1) higher crude oil prices, 2) use of ethanol in the RFG process, 3) pipeline problems, 4) low inventories, and 5) a patented RFG process.

## *Committee on Science*

F. James Sensenbrenner, Jr., Chairman

Ralph M. Hall, Texas, Ranking Democrat  
[www.house.gov/science/welcome.htm](http://www.house.gov/science/welcome.htm)

June 20, 2000

Press Contact:

Jeff Lungren ([Jeff.Lungren@mail.house.gov](mailto:Jeff.Lungren@mail.house.gov))  
 (202) 225-4275

### **CRS REPORT FINDS MIDWESTERN CONSUMERS ARE PAYING 50 CENTS PER GALLON MORE PRIMARILY DUE TO RFG REQUIREMENTS**

WASHINGTON, D.C. – House Science Committee Chairman F. James Sensenbrenner, Jr., (R-WI) and Rep. Paul Ryan (R-WI) today released a Congressional Research Service (CRS) report on the causes for high gasoline prices in Midwestern states, including Wisconsin, Illinois, and Michigan.

The report finds, "It can be roughly estimated that 25 cents of the regional [Chicago/Milwaukee] price increase is due to transportation difficulties and another 25 cents, roughly estimated, could be due to the unique RFG [reformulated gas] situation in Chicago/Milwaukee...[T]he fact that RFG prices are above conventional gas suggests that the difference is due to the supply of RFG uniquely."

The report attributes the recent Midwestern price increases to five factors: 1) higher crude oil prices, 2) use of ethanol in the RFG process, 3) pipeline problems, 4) low inventories, and 5) a patented RFG process.

Chairman Sensenbrenner has forwarded the report to Wisconsin Gov. Tommy Thompson, Illinois Gov. George Ryan, and the Members of the Wisconsin congressional delegation. Chairman Sensenbrenner also forwarded the report to House Government Reform Committee Chairman Dan Burton (R-IN) and House Judiciary Committee Chairman Henry Hyde (R-IL) because both committees are considering holding hearings on the issue of high gas prices in the Midwest.

Recent requests by Midwestern areas for waivers from the RFG Phase II requirements have not been granted by the U.S. Environmental Protection Agency (EPA).

Chairman Sensenbrenner and Rep. Ryan said, "I think this report presents a strong case for the EPA granting relief – even on a temporary basis – for consumers from the new RFG requirements. Such an action would give the public some respite from these untenably high prices without harming our environment."

**Memorandum**

June 16, 2000

SUBJECT : Midwest Gasoline Price Increases  
 FROM : Lawrence Kumins  
 Specialist in Energy Policy  
 Resources, Science, and Industry Division

**Summary**

Gasoline prices nationwide have risen about 60 cents per gallon since the beginning of 1999. Some localities – notably in Michigan, Illinois, and Wisconsin – have experienced even greater price hikes, often twice as much as the national average. These higher prices can be attributed to five factors. In summary, they are:

**Higher Crude Oil Prices.** Refiners' crude acquisition costs have risen by the equivalent of 48 cents per gallon during the past year and a half.

**Use of Ethanol in Reformulated Gasoline.** Reformulated gasoline (RFG) is required in numerous areas designated by EPA as ozone nonattainment areas. About 30% of the gasoline sold in the United States is RFG. Refiners serving the Chicago and Milwaukee areas use ethanol instead of MTBE (the additive used in most other RFG areas) to meet the oxygen requirements of the RFG program. New requirements for Phase 2 of this program which took effect June 1, 2000, have made it more difficult and costly to make RFG with ethanol. How much more costly is a matter of debate. EPA estimates the impact of Phase 2 requirements at 5-8 cents per gallon. RFG prices in Chicago and Milwaukee are at least 50 cents above RFG prices elsewhere, however. Not all of this difference can be attributed to the RFG requirements or the use of ethanol. In fact, non-reformulated gasoline sold in areas near Chicago and Milwaukee is priced well above comparable gas sold elsewhere.

**Pipeline Problems.** Two oil pipelines serving the upper Mid West have been experiencing operational difficulties. The Wolverine Pipeline between Chicago area refineries and Michigan had a spill and is slowly being brought up to capacity. It is expected to be fully operational on June 17. Meanwhile, ExxonMobil has put its branded gasoline distributors on allocation. The Explorer pipeline serving St. Louis and Chicago is operating at 10% reduced throughput, meaning St. Louis deliveries are reduced by about 50,000 barrels per day (b/d) and Chicago by about 34,000 b/d. In a tight regional market, supply reductions of this magnitude can be extremely disruptive, and lead to significant price increases.

**Low Inventories.** The EPA reports that crude oil and gasoline inventories are extremely low. There is the equivalent of about 2 days of consumption in working inventory. When stocks get this low, misallocations to the distribution system cannot easily be corrected. And refiners are slow to put extra gasoline on the market when needed because they are unable to replace

those barrels with gasoline or extra crude runs at their plants.

**Patented RFG Process.** Patents by Unocal on an important reformulated gasoline process may have some marginal impact on price and availability of RFG. However, with regional gasoline prices as high as they are, any license fee owed to Unocal once the license fee is ultimately determined would be too small to create a barrier to making RFG or the blending material for ethanol-based RFG.

In summary, some of the increased prices in Chicago/Milwaukee and Detroit can be attributed to these factors. About 48 cents of the current price is likely due to higher crude costs. This impacts gasoline consumers everywhere. It can also roughly estimated that 25 cents of the regional price increase is due to transportation difficulties and another 25 cents, roughly estimated, could be due to the unique RFG situation in Chicago/Milwaukee. These figures are very rough approximations based on spot market valuations, which do not comprise a complete series of price data. They are intended as rough estimates of each factors contribution to higher prices.

### **Oil Supply Price Background**

Retail prices of petroleum products and motor fuels have risen sharply this year. Volatile oil prices have been driven up largely by production cutbacks by the Organization of Petroleum Exporting Countries (OPEC). The reduced OPEC production quotas have combined with strong world demand to boost crude oil prices from \$10 per barrel at the end of 1998 to about \$30 per barrel by late 1999.<sup>1</sup>

OPEC output quotas also resulted in reduced petroleum stocks around the world. In the United States, crude oil and gasoline inventories are well below normal levels. Spot shortages of home heating oil and diesel fuel occurred in eastern part of the nation during winter 2000. Now that gasoline is in seasonally high demand, short supplies and instances of volatile prices are cropping up around the country. The most notable price increases are in the upper Mid West, where pump prices have exceeded \$2.00 per gallon.

Table 1 shows wholesale prices for regular grade reformulated gasoline (RFG) at important spot market trading centers around the nation. These prices do not include taxes or other charges such as transportation and dealer costs. RFG, which is oxygenated to reduce carbon monoxide emissions, must be substituted for regular gasoline in certain urban regions during the warmer months of the year.

<sup>1</sup> All prices cited in this memo are from the U.S. Department of Energy's Energy Information Administration.

**Table 1. Wholesale RFG Prices (regular grade) 6/9/00**

Location	Price range (cents/gal)
Metro NY	106 to 108
New Jersey	104 to 108
Baltimore	107 to 109
Boston	106 to 111
Norfolk	107 to 116
Philadelphia	104 to 107
<b>Chicago</b>	<b>161 to 168</b>
Dallas/Ft. Worth	106 to 110
Houston	104 to 113

Source: *Platt's Oilgram Price Report*, June 9, 2000. Page 5

While providing a one-day snapshot of RFG prices, these figures are generally representative of current marketplace conditions. They show that Chicago RFG – in round numbers – is about 50 cents per gallon above the eastern half of the nation.

*Platt's* publishes a wide array of data for regular gasoline prices at terminals around the country. On June 15, 2000, the wholesale price of regular gas was about \$1.27 per gallon in Chicago, excluding taxes and other charges. Detroit posted at a range of \$1.37 to \$1.70, a very wide band typically associated with some sort of market disturbance. The eastern part of the nation (Petroleum Allocation for Defense District 1, or PADD 1) was clustered close to the \$1.00 per gallon mark.

With Chicago RFG prices running about 50 cents above the eastern part of the nation – and regular gasoline 27 cents above – a generalized supply shortfall in the Chicago area is strongly suggested. And the fact that RFG prices are above conventional gas suggests that the difference is due to the supply of RFG uniquely. That conventional fuel is above priced above the rest of the nation suggests a shortage in the region resulting from pipeline transport problems. And with regard to Detroit, prices above the rest of the nation – as well as an usually wide range in price quotes – suggests that there may well be a supply disruption having local impact.

It must be reiterated that this effort to attribute price differentials to the availability of FG and to pipeline supply difficulties is a simplistic exercise based on incomplete data. It has been undertaken in order to separate the price effects of generalized regional shortage due to transport breakdowns from the tight supply of RFG blending material.

### Higher Crude Costs

Gasoline and crude oil reached their lowest prices in recent history in December 1998 and January 1999. In December 1998, crude cost U.S. refiners \$9.84 per barrel; in January 1999 crude was \$10.47. Similarly, gasoline of all types sold at the pump (including all taxes, etc.) for an average of \$1.05 and \$1.03 per gallon December and January.

Since that time, petroleum prices have risen consistently; in mid-June of 2000, crude is in

the \$30 per barrel area, an increase of roughly \$20 per barrel or 48 cents per gallon. It is likely that all 48 cents have been included in pump prices.

OPEC has set production quotas that resulted in much higher crude prices than were anticipated. Crude oil on the N.Y. Mercantile Exchange (NYMEX) is trading at about \$33 per barrel (bbl) as of mid-June. All petroleum products are affected more or less proportionally by high-priced crude oil, and consumers of all fuels look toward the June 21, 2000, OPEC meeting, at which a production increase is to be discussed.

### **Chicago-Milwaukee RFG**

RFG is a smaller percentage of regional gasoline supply in the mid-continent than in most other regions. Essentially, it is used only in Chicago and Milwaukee; the rest of the region uses conventional fuel. These cities have virtually banned the oxygenate MTBE from RFG sold in their cities. Instead, ethanol is used to increase the oxygen content of RFG to minimize carbon monoxide emissions. In current market conditions, the price of the gasoline base material needed for oxygenate blending (called RBOB) – rather than the cost of ethanol – has become the primary factor in the region's high prices.

The difficulty stems from the fact that RFG volatility (speed of evaporation) is limited by regulation. Ethanol is much more volatile than the major alternative oxygenate, MTBE. In order for the ethanol blend RFG to fall under the overall volatility limit, the volatility of the RBOB to be used in ethanol blending must be low. This is a matter of blending volatile ethanol – a physical fact that cannot be changed – with special reduced-volatility RBOB. The difficulty arises because low-volatility RBOB is very hard to manufacture, and there is very little demand for this material outside the Chicago-Milwaukee gasoline market. Most of the required material is made in the six refineries in Illinois (whose capacity totals nearly 1 million barrels per day). When demand exceeds local refiners' ability to manufacture low-volatility RBOB, supplies are brought in from Gulf coast refiners by pipeline.

Low volatility RBOB is a specialty product; not all refiners can or will manufacture gasoline to such specifications. And shipping presents difficulties stemming from the unique nature of the product, the need to segregate within the pipeline and the fact that it is usually shipped in relatively small quantities. Additionally, transportation bottlenecks could adversely affect the price and availability of this material in this consuming region.

### **Troubled Pipelines**

Two pipelines that play important roles in supplying gasoline to the upper Mid West are currently suffering operational difficulties. Petroleum is most efficiently transported in large quantities by pipeline. When the pipeline system has capacity problems, it can be supplemented by truck, and/or waterway transport in some cases. But pipelines' ability to move large amounts of fuel is difficult to replicate by supplementary transport, as are the low-costs inherent in pipelining.

The Explorer pipeline transports fuel from the Gulf coast to Chicago, traveling south to north and passing through St. Louis. The Explorer had a fire near St. Louis in March 2000. The damage was repaired quickly, and transport resumed. But as a result of the investigation into the incident, the pipeline company and the Department of Transportation entered into a verbal agreement to reduce operating pressure by 20%. This translates into a volumetric reduction (measured in b/d) of 10%. The Department of Energy (DOE) estimates that this has reduced the pipeline's throughput to St. Louis from 550,000 barrels per day to 500,000, creating an extremely tight local gasoline market. After St. Louis the pipeline's diameter becomes narrower to match reduced northbound requirement, although it is probable that the flow reduction in this segment of the pipeline is also 10%.

The other pipeline that is having problems is the Wolverine pipeline, which has a capacity of 186,000 barrels per day and runs eastward from Niles, Illinois, to Jackson, Michigan. A leak in early June has caused an interruption of service. Gasoline is currently being trucked around the break, which is being repaired. The pipeline is scheduled to be back in full service on June 17. While the repairs are being made, Michigan supplies have been disrupted and prices have spiked.

### **U.S. Crude Oil Inventories**

OPEC attempts to set prices by administering the level of supply sent to the world market. When OPEC members met last March, they set quotas that were not high enough for refiners around the world to rebuild crude stocks depleted by winter heating demand. Thus, low inventories are a problem around the world. In the United States, crude oil stocks are presently 20 million barrels under the normal range for this time of year, according to the Energy Information Administration (EIA). They stand at 31 million barrels above the lowest operational inventories ever observed in recent times. This is the equivalent of 2 days of refinery operations.

Gasoline stocks are in similarly tight condition. While U.S. inventories are just below the lower range of normal seasonal stocks, they are only 16 million barrels above the minimum operational level of 185 million barrels.<sup>2</sup> This means that the amount of readily marketable gasoline in the U.S. production and distribution system is the equivalent of slightly less than two days of current consumption.

When oil inventories get this close to minimum operating level, refiners' flexibility is diminished, and they are less able to deal with such factors as unanticipated demand changes, distribution difficulties, or special requirements. The latter includes such factors as the demand for RBOB suitable for ethanol blending.

<sup>2</sup> Minimum operational levels are the lowest inventory levels that have been observed in the United States in recent times. Such levels have been associated with distributional problems.



### **The Unocal Patent Issue**

Unocal, a large, integrated oil company, has substantial gasoline production in its California refineries. California has special air quality problems, and special gasoline is needed to meet California Air Resources Board (CARB) specifications, which are currently tighter than national Phase II RFG requirements. In 1990, Unocal researchers discovered a unique way of manufacturing gasoline with minimum volatility, as well as some other parameters helpful in meeting clean gasoline requirements. A patent was applied for and in 1994, the U.S. Patent and Trademark Office awarded Unocal its first patent. Four other patents were subsequently awarded to the company.

In 1995, Unocal announced its intention to license the patent to other refiners. Shortly thereafter, six major refiners sued Unocal, challenging the validity of its patents. The U.S. District court found in favor of Unocal, upholding the patent's validity and awarding Unocal damages of 5.75 cents per gallon on the gallons manufactured that infringed on Unocal's patent. In March 2000 the initial verdict was upheld in the U.S. Court of Appeals for the Federal Circuit.

How much gasoline is involved in the Unocal patent? Most gasoline is made by processes other than those patented by Unocal. In California, where CARB gasoline is often made using the Unocal process, the company estimates that only 2.9% of the gallons produced would involve its patent; 71% fell outside the patent. Around the rest of the nation, an even smaller amount would fall under the patent. Unocal has asserted that the proportion of regular RFG subject to its patent is small, but increases as octane increases. Most gasoline sold nationwide is regular grade.

Refiners have substantial latitude in which to formulate gasoline, and can choose to blend around the patents by changing the mix of ingredients. Refiners contend that, while they can often avoid the patent issue, "blending around" can cost them as much as 5 cents per gallon in higher manufacturing costs. But the patents might be a factor in the manufacturing of RBOB suitable for ethanol blending. Because of such RBOB's low volatility, it may well be dependent on Unocal's process.

At this point, negotiations about licenses and appropriate fees are beginning. There seems to be agreement on both sides that the 5.75 cents-per-gallon judgment handed down in court is too high for future license fees. It is likely that fees may be smaller when the negotiations are complete.

Meanwhile, refiners using the Unocal process without a license operate in an area of uncertainty, because the cost of licensing the Unocal process has not yet been determined. Some contend that this uncertainty created by the court decision has adversely impacted RFG production. However, given the high market prices for gasoline generally, and for RFG and RBOB specifically, prices may already be high enough to cover whatever costs might be incurred when the license fee issue is resolved.

This memorandum was prepared by the Resources, Science, and Industry Division to enable distribution to more than one congressional client.

**EXHIBIT VIII****Why RFG Inventories Must be Taken to Near Zero Levels for Spring Conversion (MAP)**

This document summarizes the nature of the inventory turnover required each spring and fall due to gasoline volatility requirements. The RFG Phase II requirements result in the most severe inventory shifts faced by the industry to date.

**WHY RFG INVENTORIES MUST BE TAKEN TO NEAR ZERO LEVELS FOR SPRING CONVERSION****BACKGROUND**

Every year the pipelines, terminals, jobbers and service stations must convert their gasoline from winter grade to summer. This process has taken place for decades because spark ignition gasoline engines need different fuel properties for satisfactory operation under winter conditions than they do under summer conditions. Vapor pressure is the primary variable that changes. Gasolines need high vaporization rates in the winter to ensure ignition and good starting. In the summer high vaporization can cause fuel line vapor lock and therefore must be avoided.

ASTM developed regional requirements for gasoline vapor pressure based on seasons of the year and geographic location. In the early 1990's EPA started requiring low Reid vapor pressure (RVP) gasoline of 7.8 psi in southern cities with ozone problems during the summer ozone season, which is defined as June 1 to September 15. In 1995 EPA started requiring Phase I RFG year round in cities with ozone problems or cities that elected to opt into the RFG program. Phase II RFG requirements went into effect January 1, 2000, with the summer specifications required to met by May 1 at the terminal level and by June 1 at the station level.

Table 1 shows the change in northern RFG summer specifications from Phase I to Phase II. The large reductions in VOC emissions forces drastic reductions in RVP as can be seen in Table 2

**TABLE 1**  
**PHASE I VS PHASE II FOR NORTHERN, SUMMER RFG**

	PHASE I RFG	PHASE II RFG
VOC EMISSION REDUCTION, %	17.1	27.4
NO <sub>x</sub> EMISSION REDUCTION, %	1.5	6.8
TOXICS EMISSION REDUCTION, %	16.5	21.5
OXYGEN CONTENT, WT%	2.1	2.1
BENZENE, VOL %	0.95	0.95

**TABLE 2**  
**EXPECTED VALUES OF KEY RFG PROPERTIES**

	PHASE I RFG	PHASE II RFG
RVP, psi	7.8-8.3	6.8-7.0
SULFUR, ppm	330-500	150-170
BENZENE, WT%	0.95	.7-.8

**PAST CONVERSIONS WITH CONVENTIONAL GASOLINE**

In the past tanks could be converted to the lower RVP requirement simply by lowering the tank volume and moving in a batch of sub-RVP gasoline. For example a tank of 12.0 psi gasoline could be converted to 8.0 psi by lowering the level to 20% of operating capacity and then filling

remainder of the tank with 7.0 psi gasoline. This operation requires an accurate prediction of sales to be certain that the remaining tank volume is below the targeted level and accurate pipeline movements to be certain that the new batch of lower RVP gasoline arrives after the targeted level has been reached but before the tank is empty and sales have to be stopped. This situation is compounded by a distribution network that in many cases has three to five tanks sequentially in series that must be converted one after the other. For example after MAP's Texas City refinery converts its refinery tanks, batches must be sent to convert tankage at the Pasadena terminal, after this Explorer tankage must be converted, then MAP's Griffith tankage, then tankage at the Chicago terminals and finally the station tanks must be converted. Milwaukee and Cleveland have similar supply chains.

Using the example above for a four tank distribution chain, assuming all the tanks start with 13.5 psi gasoline (the typical RVP going into conversion season) and are at 20% when new batches arrive, you can calculate that the first batch of 7.0 psi gasoline converts the first tank to 8.3. But that 7.0 RVP batch converts the second tank in the system to 9.3, the third tank to 10.2 and the fourth tank to 10.8 RVP. In this example it takes three consecutive 7.0 psi batches until the fourth tank is below the targeted 8.0 RVP. Given 20 days of shipping time, it takes two months of perfect operations, selling exactly at forecast and with no change in pipeline delivery schedules to convert this system of four tanks.

### 3 CONVERSIONS

From Table 2 the targeted range for Phase I RFG was 7.8 to 8.3 RVP. Thus, the four tank example above roughly approximates how tanks were converted to Phase I RFG summer gasoline in the north. It should be noted that if sales were below forecast or pipeline deliveries came ahead of schedule, the fourth tank in the system, most likely a terminal tank would be full of off spec material. Unless this tank volume can be sold before May 1, it will remain full of material that can not be sold until after September 15 and thus it is effectively out of service for summer.

Summer grade northern Phase II RFG, however, has a targeted RVP of 6.8 to 7.0 (Table 2). Summer grade RFG also has a minimum RVP requirement of 6.4 psi to be certified at the refinery gate. The addition of even 5% of 13.5 psi RFG to a 6.4 RVP batch reaches the 6.8 RVP target. Further complicating the situation is the fact that the measurement reproducibility for RVP is +/- 0.3 psi. This effectively means that the lower limit and the targeted RVP are virtually the same and conversion from a 13.5 psi RVP using the traditional tank conversion procedure will not work for Phase II RFG. The only workable solution is to nearly empty the tank before the new batch arrives.

The requirement to empty RFG tanks as they are converted in the spring results in a drastic reduction in RFG stocks during this time period. Unless this inventory reduction can be quickly rebuilt, the entire RFG distribution system is vulnerable to refinery upsets or distribution problems.

### EXHIBIT IX

.. Frank letter to the editors; The Courier, The Cincinnati Post, and the Detroit News, June 20, 2000

The attached exhibit is an editorial letter written by J. L. Frank to the Findlay Courier, June 20, 2000.

A4

**The Courier**  
The Findlay Publishing Company

THE COURIER, TUESDAY, JUNE 27, 2000

# VIEWPOINT

## Why gasoline soared

### Interruptions, regulations reduced supply

By J.L. "CORKY" FRANK

Consumers are understandably concerned about the recent surge in gasoline prices, particularly those in the Midwest. Much of the increase nationwide is related to the price of crude oil, which has nearly tripled since January 1999, and to the implementation of regulations which force refiners to produce an ever-widening array of motor fuels for different markets. In addition to these factors, the Midwest has been experiencing an imbalance of gasoline supply and demand. The primary causes of this imbalance are new fuels required June 1 for the Chicago, Milwaukee and St. Louis markets and a series of pipeline and refinery disruptions.

As is frequently the case, the market initially reacted to this supply-demand imbalance with sharp price increases. However, thanks to a highly competitive market, and to the extraordinary efforts of hard-working men and women of Marathon Ashland Petroleum and other companies in the industry, there are indications that relief is forthcoming.

This situation illustrates the fragile nature of petroleum product supply and distribution in the Midwest. It also highlights the need for improvements in the supply and distribution system, and for a different approach to fuels regulations, in order to avoid similar problems in the future.

By way of background, the Midwest's refining capacity satisfies only about 75 percent of the region's demand for petroleum products. Consequently, gasoline and other products must be imported into the Midwest by pipeline and barge from the nation's other refining centers at a rate of more than 42 million gallons per day. When significant interruptions occur in the transportation system, the supply balance is quickly upset.

One such event occurred in March of this year, when Explorer Pipeline, a major source of petroleum products from the Gulf Coast to Chicago, suffered a leak. This incident resulted in the loss of approximately 330 million gallons of product to the Chicago market, which is a major transshipment point for the Midwest. The lost supply could not be replaced due to a lack of available capacity on Explorer or other systems. When the Explorer Pipeline returned to service, it was not allowed to operate at full capacity due to regulatory constraints. This reduced capacity continues to impact gasoline deliveries to the Midwest at a rate of about 63 million gallons per month.

Meanwhile, as Chicago inventories dwindled, the U.S. EPA granted a waiver postponing the use of reformulated gasoline in the St. Louis market. The EPA urged marketers in St. Louis to use conventional gasoline for immediate consumption, and at the same time to build supplies of reformulated gasoline for sale when the waiver expired. This worsened the supply shortage in the Chicago market.

As product supply grew

**From my company's perspective, the supply situation seems to be coming back into balance and when this is accomplished, market forces will do their job on the price front.**

Higher in the Chicago market, it began to affect surrounding markets. This included Michigan, which receives significant supplies from Chicago on the Wolverine Pipeline system. On June 7, Wolverine Pipeline suffered a leak, requiring much of its pipeline system to be shut down for a total of nine days. Wolverine Pipeline resumed operation last Friday, but, again, regulations require that it operate at less than full capacity. This pipeline outage, in an area where product was already in short supply and where demand was strong, had a devastating effect on inventories. This resulted in a corresponding increase in prices as market forces acted to allocate scarce product.

A series of other Midwest supply interruptions and refinery outages also occurred in recent months and each event adversely impacted supplies in the Midwest.

These incidents occurred in a supply and distribution system already challenged by the need to supply multiple grades of gasoline now required by environmental regulations. For example, in our 21-state marketing area, we once transported and stored just three grades of gasoline. Now we handle 16 grades, including EPA's Phase II reformulated gasoline. This new gasoline, which was required at retail locations for the first time on June 1, proved more difficult and expensive to make than previous specifications.

Not every refinery can economically produce every grade of fuel that environmental regulations now require. The sheer number of fuel grades has forced refiners to choose which ones they will produce. If one refiner is unable to produce a particular fuel grade, there is the possibility that other refiners may not have the capacity to make up the shortfall. This can lead to supply shortages until markets have the chance to react.

Another major logistical challenge occurs each spring and fall when winter gasoline stocks must be changed for summer stocks or vice versa. In preparation for this summer's changeover, environmental regulations forced refiners and marketers to virtually empty their storage tanks and start the driving season with lower product inventories than in previous years.

As a result of all these factors, gasoline supplies in the Midwest this spring, including blending components used to make reformulated gasoline, were 15 percent below the five-

year average for the region and the lowest since 1981, according to the U.S. Energy Department. The imbalance of supply with demand, coupled with a rebound in crude oil prices, resulted in sharply increased gasoline prices in many Midwest markets.

I'm proud to tell you that the men and women of Marathon Ashland Petroleum have worked around the clock to help remedy this situation. In addition to running our refineries at capacity, we've taken extraordinary measures to deliver products to the Midwest. For example, we have brought in additional, higher cost trucking resources from as far away as Louisiana, Texas and Florida to transport products from sources not normally used to supply these markets and have used barges to move product into the region from as far away as the New York Harbor, Newfoundland, Canada and the Gulf of Mexico.

From my company's perspective, the supply situation seems to be coming back into balance and when this is accomplished, market forces will do their job on the price front. However, let me caution that the Midwest's supply and distribution system is delicately balanced. As we have seen in recent weeks, one unfortunately timed incident or a new round of regulatory requirements can put tremendous pressure on this system.

Marathon Ashland Petroleum is currently working on several projects that could help ease situations like the one we are experiencing now. We're seeking rights of way and permits to construct a new refined petroleum products pipeline to serve the growing central Ohio market, but our progress has been hampered due to right-of-way litigation. We've also joined two other companies to convert a natural gas pipeline into a new products pipeline from the Gulf Coast to the Midwest, including the Chicago area. Federal and state governments could help by expediting the permitting process for these significant projects as well as others our company and the industry have planned, and by rethinking the dynamics on our industry posed by new fuels regulations. Until changes occur, we will operate with a system in which any upset can cause potentially significant supply shortages and resultant price increases.

The Federal Trade Commission has announced that it is conducting investigations of our industry's pricing practices. While we would prefer the government use its resources to help the industry with projects that would improve our infrastructure, we know that it is not unusual for such investigations to be launched during times of volatility in gasoline markets. Our company's record of being exonerated by these investigations is spotless. We're confident that the current investigation will yield the same results. In the meantime, we will continue to work as hard as possible to provide products to our customers.

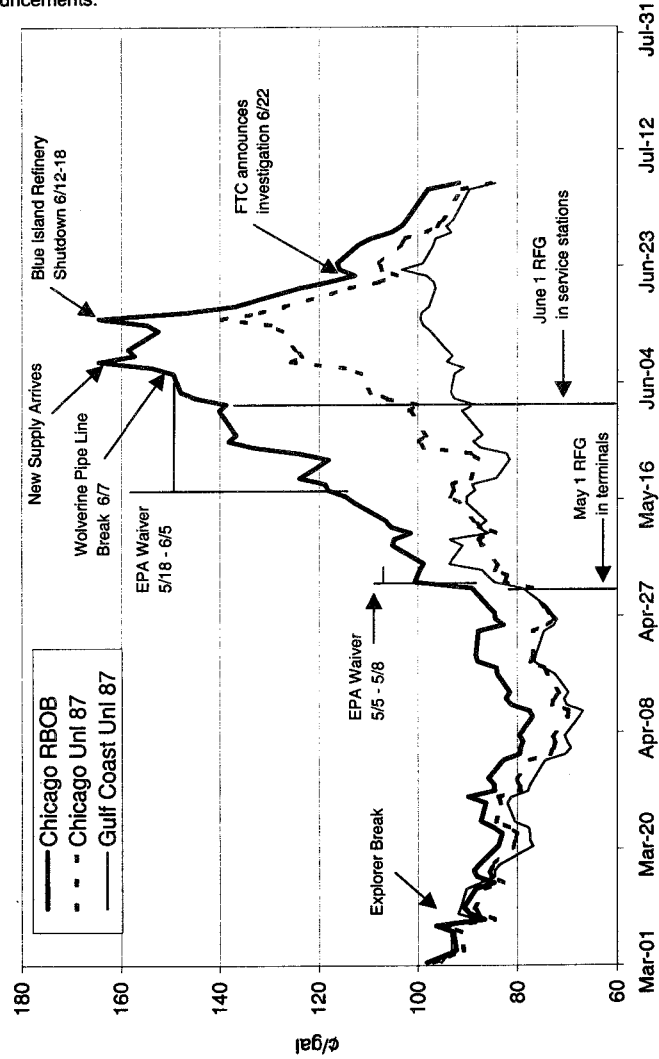
J.L. "Corky" Frank is president of Marathon Ashland Petroleum Company LLC.

## EXHIBIT X

Chicago Market Wholesale Gasoline Price Chart (Source: Platts)

Chart of Chicago market wholesale gasoline prices, March 1 to June 30, 2000. The data shows the timing of pipeline disruptions, RFG availability requirements, and EPA waiver announcements.

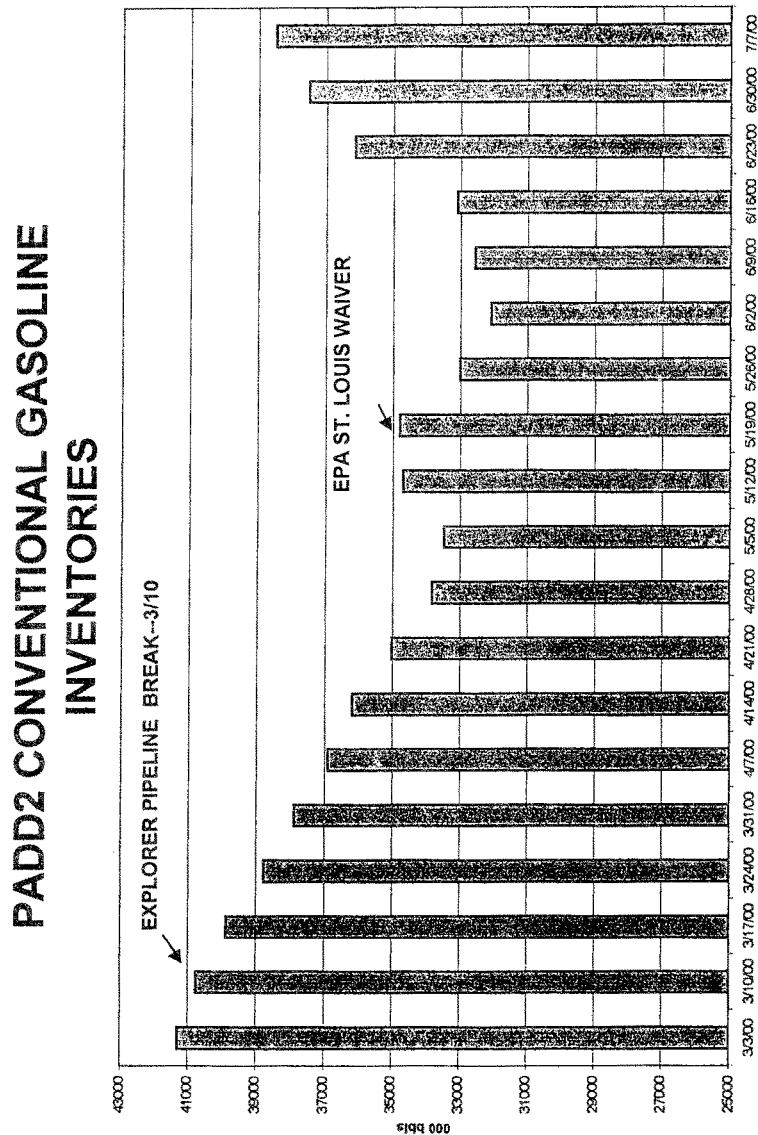
## Chicago Market Unleaded Gasoline Prices



## EXHIBIT XI

## PADD2 Conventional Gasoline Inventories (Source: API, Weekly Bulletin")

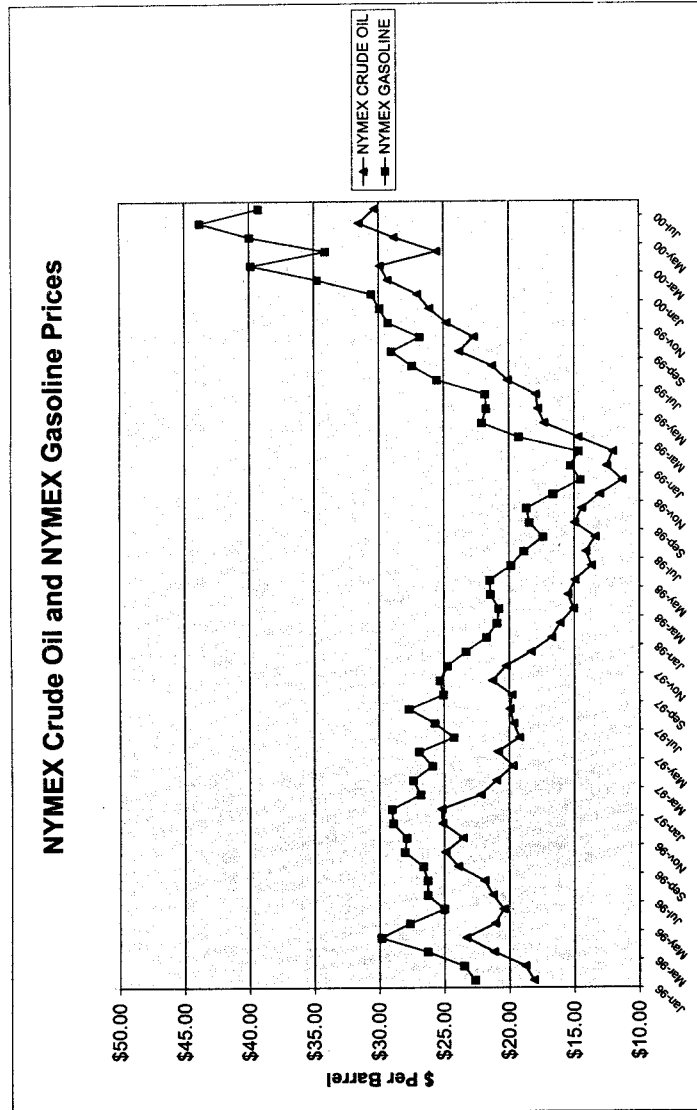
Chart of PADD 2 conventional gasoline inventories, weekly for March through June 2000. The chart shows the remarkable decline in the level of gasoline stocks due to the Explorer pipeline disruption and other factors.



## EXHIBIT XII

## NYMEX Crude Oil and NYMEX Gasoline Prices (New York Mercantile Exchange)

Chart of NYMEX crude oil and gasoline prices. The data clearly shows that gasoline price changes have generally been in line with crude oil price changes from 1996 through to the present.

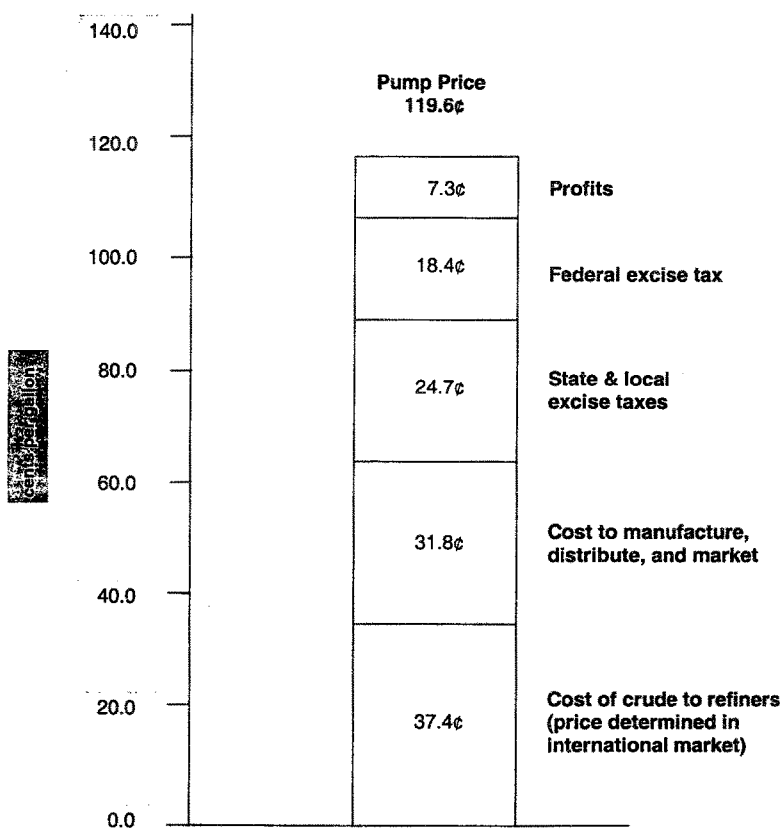


## EXHIBIT XIII

**Components of the Pump Price of Gasoline (API, Consumer Information Report: "Profits are Small Part of the Pump Price for Gasoline", April 14, 2000)**

This chart visually depicts the various components of gasoline retail prices (in cents per gallon), taken as the average from January, 1997 through September, 1999. The data illustrates that the delivered cost of crude oil accounts for 37 cents, the costs to manufacture, distribute and market add 32 cents, state and local taxes add 25 cents, federal excise tax is 18 cents, and refining and marketing profits averages just 7 cents.

**Components of the Pump Price of Gasoline  
(average for period January 1997 - September 1999)**



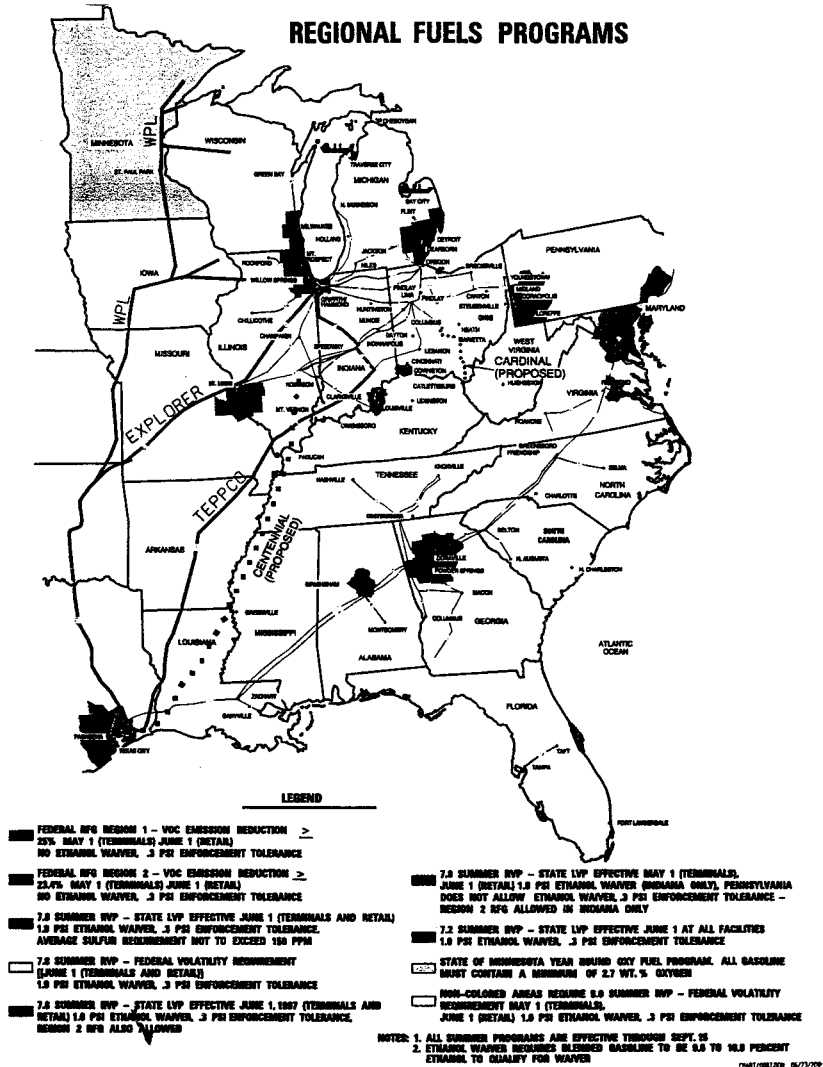
Source: API Consumer Information Report: *Profits Are a Small Part of the Pump Price for Gasoline* 4/19/00



## EXHIBIT XIV

## Regional Fuels Supply Map (MAP)

This map depicts the numerous regional gasoline programs mandated by states and municipalities as part of their EPA attainment plans and the petroleum product pipelines that service the Midwestern states. It helps explain the strain that multiple gasoline specifications place on the transportation facilities and how local supply shortfalls can easily occur due to pipeline accidents.

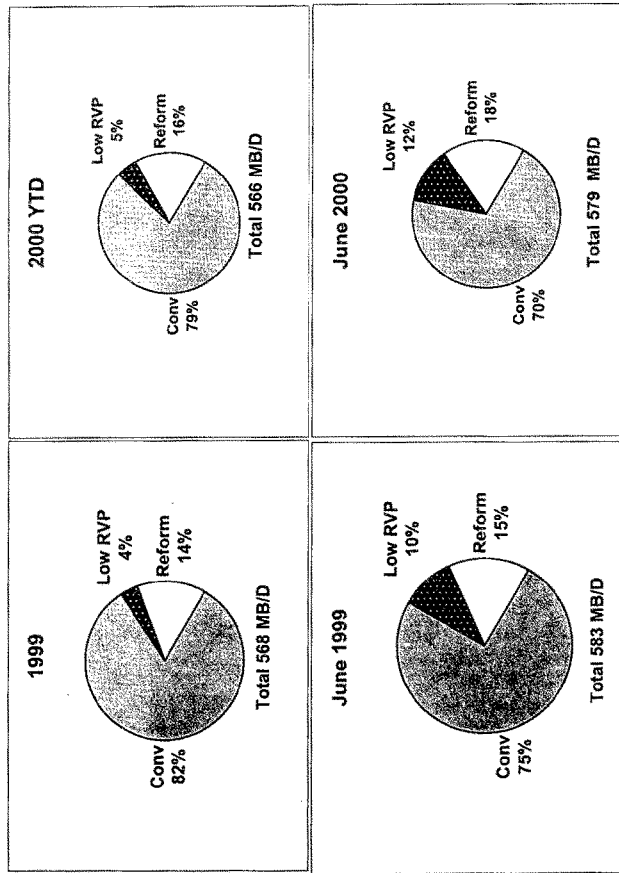


## EXHIBIT XV

## MAP Refining Gasoline Production Comparison (MAP)

This chart shows Marathon Ashland Petroleum refinery gasoline production by grade for 1999 and June year-to-date 2000. The data illustrates that the production of low RVP and reformulated gasoline increased as a percent of total refinery output. The graphs of June production highlight the year-to-year changes in the gasoline grade mix.

## MAP LLC Refinery Gasoline Production



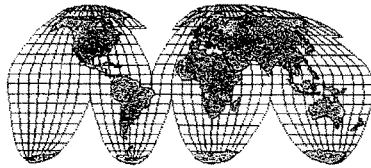
7/11/00

MAPGslProd.xls

## EXHIBIT XVI

**Energy Information Administration, "Update: A Year of Volatility-Oil Markets and Gasoline"**

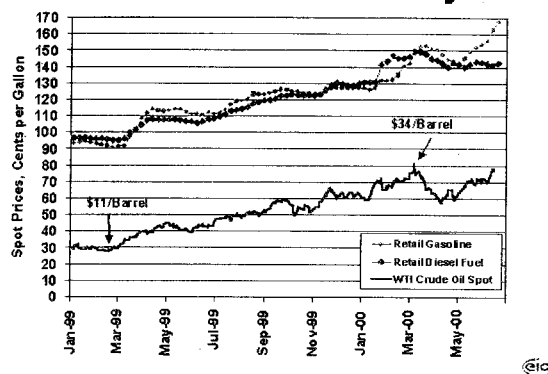
This report notes that while nominal gasoline prices were much higher than at this time last year, they are much less than the prices experienced in the first half of the 1980's when adjusted for inflation. World crude oil prices are expected to decline as increased oil production from OPEC and others enter the market.

**Update: A Year of Volatility  
Oil Markets and Gasoline**

**June 20, 2000**  
**Energy Information Administration**



### Retail Product Prices Driven by Crude

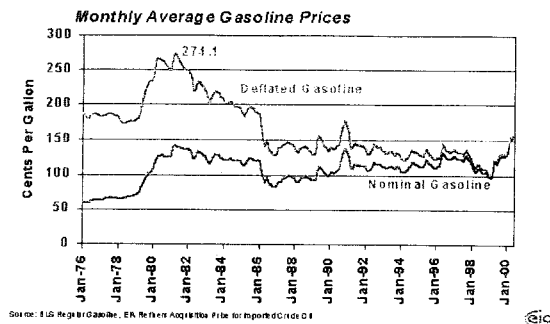


Slide 2 of 17

#### Notes:

- Retail prices for both gasoline and diesel fuel are much higher this year than last, driven mostly by the rise in world crude oil prices to their highest levels since the Persian Gulf War.
  - The U.S. average retail regular gasoline price reached nearly \$1.70 per gallon Monday, June 19.
  - Retail on-highway diesel fuel prices peaked at almost \$1.50 per gallon on March 13, but have declined to hover just over \$1.40. On June 19, U.S. prices averaged \$1.42.
- While movement in underlying crude oil prices has been the major driver for prices of products, low product inventories have caused increased price spreads between product prices and crude oil, further adding to consumer prices.
  - Gasoline prices have recently been pushed upward by concerns over the adequacy of summer supplies, including refinery problems producing summer RFG during the winter-to-summer transition and the uncertainties surrounding the ability of foreign refineries to make Phase II summer RFG and the Unocal RFG patent issue.
  - Diesel fuel prices, by comparison, rose sharply starting in late January due to low inventories and high demand for heating fuels. While diesel fuel prices have recently softened as the heating season ended, prices may turn upward again if crude oil prices remain high. Strong demand this summer in combination with low stocks would also put upward pressure on diesel fuel prices this summer.

### Gasoline Prices in Inflation-Adjusted Terms

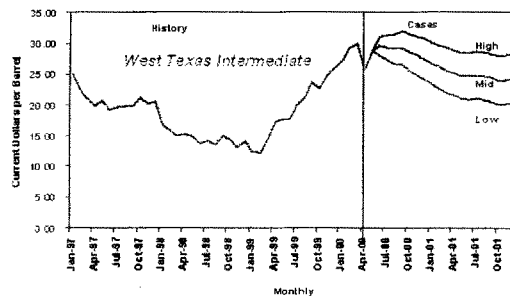


Slide 3 of 17

#### Notes:

- While EIA has noted that from an economic viewpoint, prices today are not that high in real terms, consumers seem to react more to rapid changes than overall levels.
  - Today's gasoline prices, now at almost \$1.70 for regular unleaded gasoline, are much less than prices experienced in the first half of the 1980's when adjusted for inflation. Crude oil peaked at almost \$39 nominally in 1981, which is equivalent to \$76 per barrel in today's dollars.
  - Yet consumers remember the low prices they paid last year, and organizations budgeted their usual percentage increase for fuel purchases, only to find that those percentages were way too low.
- Price volatility often can be of more concern to consumers in the short run than price level itself. Volatility makes planning and budgeting more difficult, and when prices increase rapidly, they can catch consumers unprepared.

### Crude Oil Prices High But May Relax Some By Year's End



Sources: History: EIA; Projections: Short-Term Energy Outlook, June 2000.

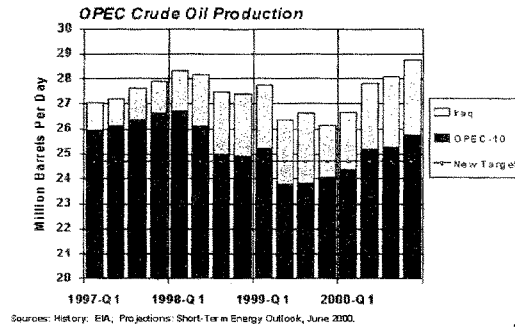
EIA

Slide 4 of 17

#### Notes:

- Current WTI prices over \$30 per barrel reflect uncertainties in supply, on top of inventories that are still low, despite some recent improvements.
- World oil prices are expected to show a gradual decline as increased oil production from OPEC and others enters the world oil market, although the actual path may not be as smooth as that shown on the graph. The average price of WTI was almost \$30 per barrel in March, but dropped to \$26 in April as the market responded to the additional OPEC production. However, prices strengthened again and recently have been staying over \$32, as growing gasoline production needs pull on the crude market in the face of low crude oil and gasoline stocks. EIA expects adequate OPEC supplies to be introduced into the market throughout the rest of the year to bring WTI crude oil price down somewhat by year end.
- These crude oil price projections reflect:
  - Fairly low world demand growth during 2000 of 1.7 percent, or 1.3 million barrels per day.
  - Non OPEC production growth during 2000 of over 1.2 million barrels per day.
  - Growth in Iraqi production of 700 thousand barrels per day from Q1 to Q4 2000. Iraqi production is estimated at 3.0 million barrels per day in the fourth quarter 2000.
  - Growing OPEC leakage over the current OPEC target.

## EIA OPEC Production Assumption Projects Increasing Leakage

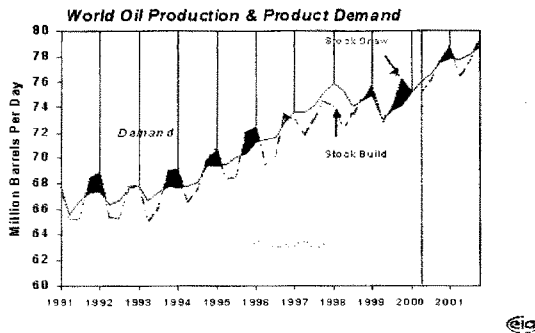


Slide 5 of 17

### Notes:

- Production levels for all of OPEC (including Iraq) are assumed to rise about 2.1 million barrels per day from the first quarter to the fourth quarter this year.
- The EIA base case assumes OPEC-10 production (excluding Iraq) will increase about 1.4 million barrels per day from first to fourth quarter, putting them almost 1.1 million barrels per day over their new quota by the end of 2000.
  - In the second quarter, OPEC-10 production is assumed to exceed the new quota by 0.5 million barrels per day, returning to the levels of production in early 1999.
  - OPEC-10 production in the third quarter is assumed to be close to second quarter production, and production in the fourth quarter is assumed to rise about 0.5 million barrels per day over second quarter.
- Iraqi production is assumed to increase almost 0.7 million barrels per day from first to fourth quarter, which could be optimistic depending on their ability to keep their oil supply infrastructure intact.

## Supply/Demand Forecasts Leave Little Room for Winter Drawdown



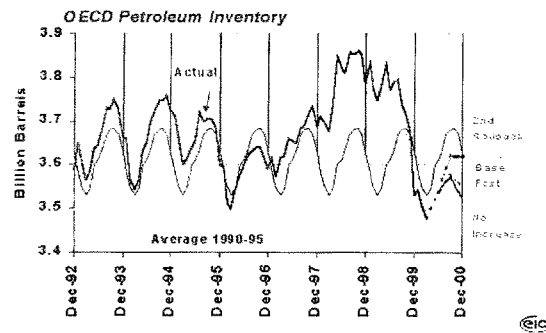
Slide 6 of 17

### Notes:

- During 1999, we saw stock draws during the summer months, when we normally see stock builds, and early estimates indicate we had very large stock draws this past winter.
  - Normally, crude oil production exceeds product demand in the spring and summer, and stocks build.
  - These stocks are subsequently drawn down during the fourth and first quarters (dark blue areas). When the market is in balance, the stock builds equal the draws.
- As we look ahead using EIA's base case assumptions for OPEC production, non-OPEC production, and demand, we expect near normal stock building during summer 2000 -- about 800 thousand barrels per day second quarter and 500 thousand barrels per day in the third quarter 2000. But since we are beginning the summer with very low stock levels, even a normal build will have us entering the winter with seasonally low stocks.
- While the base case begins the winter 2000/2001 with low stocks, EIA's assumptions have OPEC increasing production enough to minimize stock draws over the winter months, and support prices in the \$25-\$30 range.



### Price Volatility Will Remain Until Inventories Rebuild

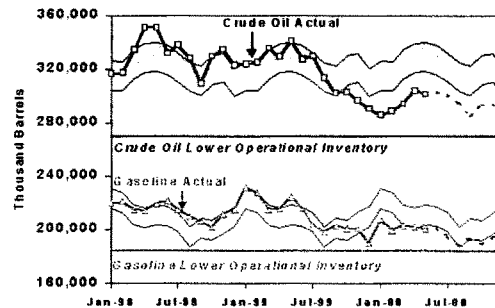


Slide 7 of 17

#### Notes:

- In EIA's forecasts, the base case assumptions have OECD inventories remaining low for the rest of the year. Even with EIA's assumed OPEC leakage increases and rising Iraqi production, supply is not quite sufficient in the base case for a normal stock build in either the second or the third quarter.
- This year, prices fell with April's increase in OPEC production, but recently rebounded to earlier high levels as strong demand and concerns over third quarter supply have added pressure to the market.
- There still is much uncertainty ahead. Prices could fall back if OPEC announces sizeable production increases at their June meeting. But prices could turn back up in the third quarter, depending on the weakness of the third quarter stock build in preparation for the high-demand winter quarters.

## Low Stocks Mean Tight Markets



NOTE: Colored Bands are Normal Stock Ranges

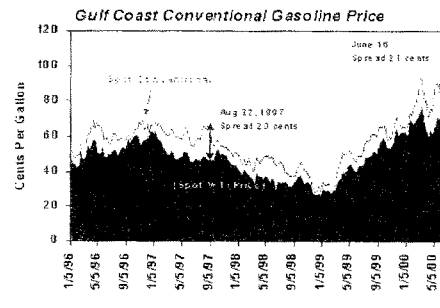
EIA

Slide 8 of 17

### Notes:

- Similar to the EIA base case projections for OECD petroleum stocks, U.S. stock projections are expected to remain low through the rest of this year.
- This chart shows two important components of U.S. stocks, crude oil and gasoline. While stocks are currently low, they did improve somewhat in March and April.
  - Crude oil inventories are still below normal levels.
  - Gasoline stocks at the end of February had dropped about 5 percent below the low end of the normal range. Gasoline inventories are now at the low end of the normal band.
- The U.S. inventory data, which are accurate and timely, will be an important price barometer to watch. Low inventories leave little cushion to absorb unexpected events such as refinery or logistical disruptions.

## Tight Markets Lead to High Gasoline Spreads

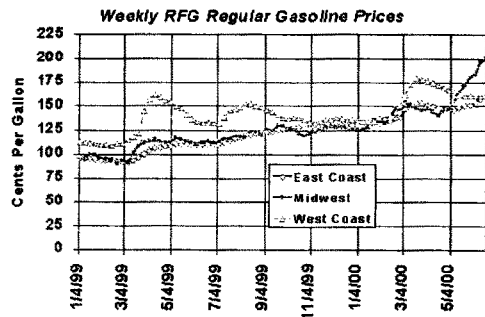


Slide 9 of 17

### Notes:

- Low crude oil and product stocks tend to mean high crude oil and product prices
- Low gasoline stocks in the spring and summer increase the price of gasoline relative to crude oil. The difference between gasoline spot prices and crude oil spot prices are shown as the green band in the graph.
  - During May, this gasoline price spread is typically about 12 cents per gallon
  - In May 1999, the gasoline price spread averaged 6 cents per gallon.
  - In May and June 2000, it averaged about 20 cents per gallon, similar to the spreads seen during late summer 1997, when we had a gasoline price runup as demand outstripped capacity for a time.
- Accompanying low stocks and high gasoline spreads is the increased potential for price volatility.

### MidWest RFG Price Rose Quickly



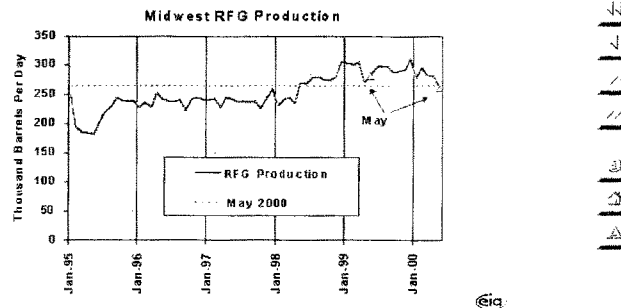
EIA

Slide 10 of 17

#### Notes:

- The gasoline market is tight throughout the United States, but the impact can be more pronounced on RFG than on conventional gasoline.
- Midwest RFG is showing the first signs of gasoline price volatility this summer.
  - This is stemming mainly from St. Louis, Chicago and Milwaukee.
  - The loss of supplies to St. Louis coming from the Explorer Pipeline created high RFG prices in that area.
  - Chicago and Milwaukee will be discussed in more detail later in the presentation.

### Midwest RFG Production Somewhat Low

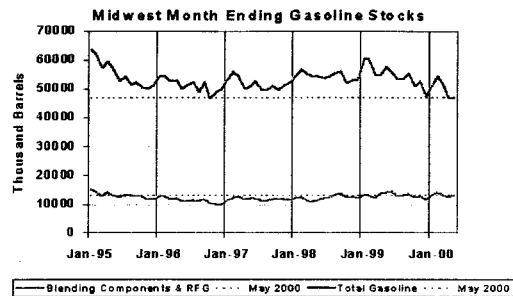


Slide 11 of 17

#### Notes:

- RFG production in total for Midwest has been somewhat low the past couple of months, but these production levels do not indicate a critical supply situation is likely in the near term.
- However, gasoline demand in Midwest seems to be growing more strongly in 2000 than it has for the past couple of years in this region. Weak production combined with strong demand can cause inventories to be drawn down faster than usual.
- Furthermore, in the Chicago and Milwaukee RFG areas, which account for over 2/3 of Midwest RFG consumption, the RFG is almost exclusively made by blending ethanol with blending components called "reformulated gasoline blendstock for oxygenate blending" or RBOB at local terminals. Most of the RBOB comes from about 7 refineries that serve that area. (Some additional RBOB comes from a few additional refineries on the Gulf Coast.)
- The summer-grade RBOB that gets blended with ethanol is fairly difficult to make, and not many refineries outside of the Chicago/Milwaukee area produce the product. With the Phase II RFG program, some refiners were unable to produce as much RBOB as last year, and others were able to produce more. This created a change in supply patterns to which the markets are adjusting.

### Midwest Conventional Stocks Very Low; RFG Not As Extreme



EIA

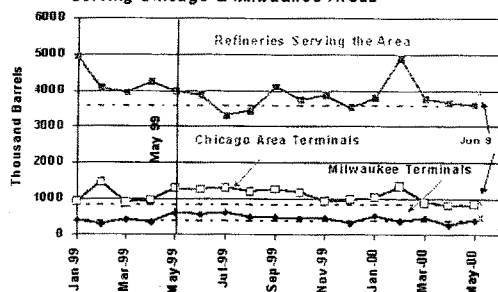
Slide 12 of 17

#### Notes:

- Midwest gasoline stocks (including blending components which are used to make RFG) are very low. Total gasoline stocks at the end of May are about 13% lower than the five year average for this time of year, and the lowest ever since 1981 when EIA began collecting this data.
- With the addition of a new RFG region, St. Louis, into Midwest, one would expect RFG and blending component stocks to increase in total. But they did not. They are at about the same levels as we saw in 1998 and 1999 at this time of year. St. Louis added about 18% demand to the RFG market in Midwest, but without a corresponding increase in overall inventory levels. ✓

## Regional Inventories Low

Blending Component & RFG Inventories in  
Serving Chicago & Milwaukee Areas



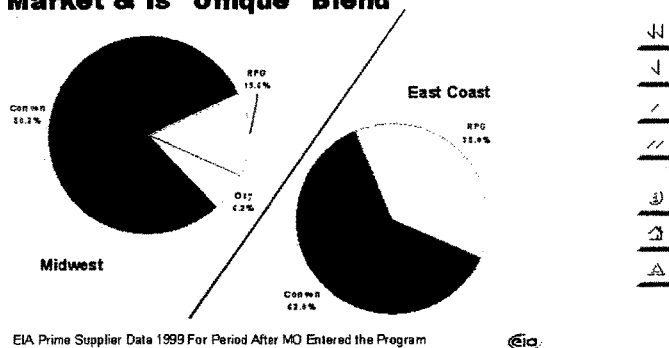
© 2000

Slide 13 of 17

### Notes:

- In the Chicago and Milwaukee areas, inventories of blending components used to make RFG and RFG are low, particularly at the Chicago terminals and at the 7 refineries supplying the area.
  - About 3/4 of the blending component and RFG gasoline inventories are stored at the main Midwest refineries that produce RFG for the Chicago and Milwaukee areas, and 1/4 at the terminals.
- The latest weekly data for June 9 indicate there may be some increases in supply occurring, as evidenced by the increases in refinery stocks and slight increases in terminal stocks. Furthermore, spot prices in the Chicago area began to fall at the end of last week, which also provides an indication that the supply situation may be improving. Still the area is functioning with no room for error, so this improvement can quickly disappear if any further problems develop.
- Once the region begins to recover, there will be some delay before wholesale price improvements are seen at the retail level.

### Midwest RFG Is Small Fraction Of Market & Is "Unique" Blend



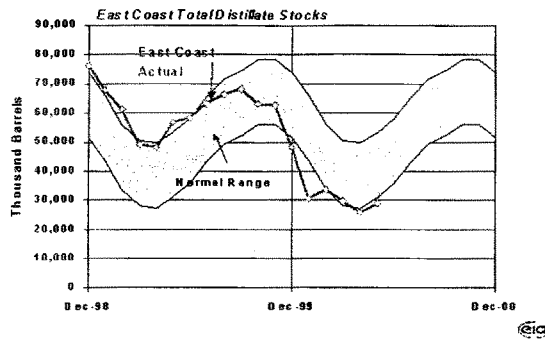
Slide 14 of 17

#### Notes:

- Why has there been such a large RFG price increase in the Chicago/Milwaukee areas?
- There is no one answer. A large part of the price reaction to the region's low stocks stems from the small size of this market, the unique nature of the area's summer-grade ethanol-blended Phase II RFG, and a difficult transition from the winter to the summer grade gasoline.
  - The RFG market in the Midwest is about 13% of the Midwest total gasoline market, compared to the East Coast, where RFG represents about 38%. A small market has fewer nearby options for product when any problems occur. Furthermore, because RFG is relatively expensive to produce, the industry has a disincentive to store extra product.
  - The special gasoline blend used in this area during the summer is produced at refineries and sent to terminals near the local market to be combined with ethanol in order to produce the finished RFG. While that special blend can be produced on the Gulf Coast by a few refineries and shipped to Chicago and Milwaukee terminals, it is both a difficult and relatively expensive material to produce and a long trip to the final destination. Thus, an initial price runup does not immediately bring in new supplies from outside the region.
  - The complexity of the transition from winter to summer grade gasoline also contributed to the problem. Many storage tanks had to be drained completely before the new summer-grade product could be added in order to preserve the clean fuel qualities. This exposed the area to very low stocks during the transition. Also some refineries produced less RFG blending component volumes this year than last and others produced more, which required market distribution adjustments.
- Contributing to the problem are the uncertainties surrounding supply that result from the temporary West Shore pipeline shutdown and the UNOCAL patent, which is lending uncertainty to all RFG producers.



### While Gasoline Has the Limelight, Distillate Is Being Watched

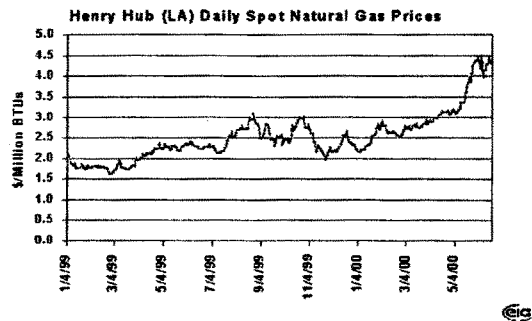


Slide 15 of 17

#### Notes:

- While the public is currently focusing on gasoline, EIA is watching the distillate market closely.
- As the normal stock band shows, we typically build distillate stocks during the summer for use during the winter.
- Given the low gasoline stocks, it is unlikely refinery yields will be tilted to diesel versus the normal pattern, so at best, the distillate fuel oil build will be normal. In this case we would begin the winter with below average stock levels.
- Below average stock levels translate to increased potential for price volatility.

## Natural Gas Supply Concerns Driving Up Prices



Slide 16 of 17

### Notes:

- Natural gas prices are surging as summer gets underway. Utility demand for natural gas usually peaks during the summer, but supplies this year are in question.
- While increasing crude oil prices have probably helped to move natural gas prices higher through March and April, the latest May surge seems to be stemming from a confluence of factors raising concerns over the ability of supply to meet the peak summer demand days this year. The concerns center on:
  - A hot summer being expected this year;
  - A larger share of power generation using natural gas -- especially with the addition of some new merchant power plants expected to be in service this June;
  - The hurricane season beginning, which affects natural gas production;
  - Overall demand growth eating into excess deliverability;
  - Natural gas inventories lower than last year, and, while not at record absolute lows, providing less coverage as measured in days of supply.
- Ironically, an important alternative fuel for the electric generating companies is distillate fuel oil. If natural gas prices remain high, utilities may use more distillate this summer, hindering a buildup of heating oil stocks for the winter.

### Conclusion: Volatile Prices Likely in the Year Ahead

Gasoline markets: Low stocks, high prices, volatility

Winter heating fuel: May have low inventories going into winter, resulting in price volatility

Natural gas: High prices and supply concerns may impact distillate stock build for winter and can mean high natural gas prices this winter

But maybe OPEC will add more supply, stocks will build, and prices will fall



EIA

Slide 17 of 17

#### Notes:

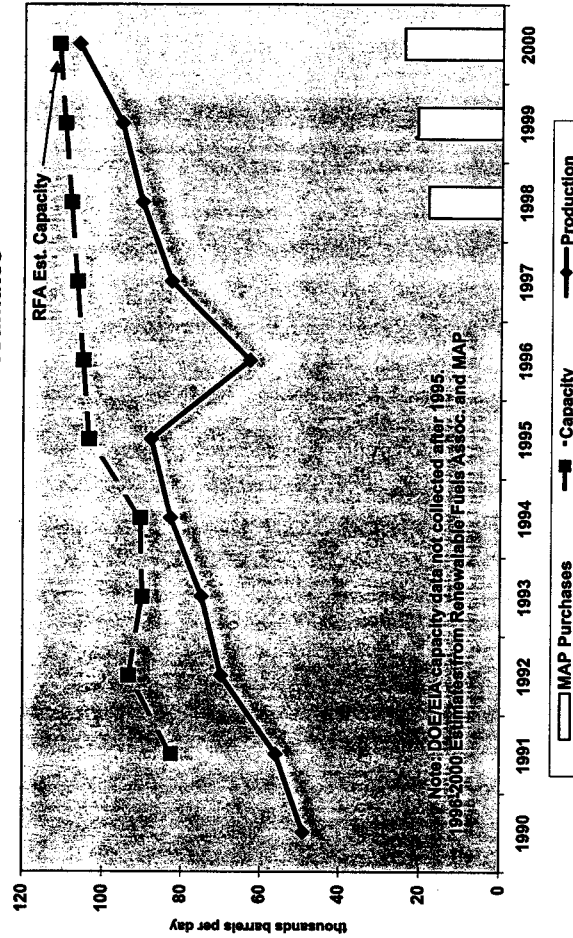
- In conclusion, EIA believes we may see more price volatility in the oil markets before the inventory situation improves, and inventories will not improve quickly as petroleum demand remains fairly strong and worldwide production does not keep pace.

## EXHIBIT XVII

U.S. Ethanol Production and MAP Purchases (DOE/EIA, Renewable Fuels Association and MAP data)

This chart illustrates U. S. fuel ethanol production and capacity, as well as MAP's purchases of ethanol. Ethanol capacity is nearing full utilization and the Renewable Fuels Association predicts significant capacity additions in the near term. MAP is the largest purchaser of fuel ethanol in the United States.

U. S. Fuel Ethanol Capacity and Production  
Source: DOE/EIA and MAP estimates



## EXHIBIT XVIII

CRS Report, "Environmental Protection Agency Options for Ameliorating the Effects of Reformulated Gas Requirements in the Chicago/Milwaukee Area", June 28, 2000.

This report examines EPA options for ameliorating the effects of Reformulated gasoline in the Chicago/Milwaukee area. The report explains the fact that the EPA election to use enforcement discretion in waiving the RFG requirement for St. Louis was a problematic course of action. EPA could have chosen to waive the RFG provisions by other legal means provided for in the Clean Air Act.



Congressional Research Service · Library of Congress · Washington, D.C. 20540

---

*Memorandum* June 28, 2000

---

TO : House Government Reform Committee  
Attention: Mildred Webber

House Science Committee  
Attention: Richard Russell

FROM : Morton Rosenberg  
Specialist in American Public Law  
American Law Division

SUBJECT : Environmental Protection Agency Options for Ameliorating the Effects  
Of Reformulated Gas Requirements in the Chicago/Milwaukee Area

---

The Clean Air Act amendments of 1990<sup>1</sup> required areas with poor air quality to add chemicals called "oxygenates" to gasoline as a means of improving combustion and, thereby, reducing emissions.<sup>2</sup> Section 211 (k) of the Act<sup>3</sup> and the regulations promulgated thereunder<sup>4</sup> prohibit the sale of conventional gasoline in an area in which reformulated gasoline (RFG) is required. Violators of the regulatory requirements may be assessed a civil penalty of up to \$25,000 for each day of such violation as well the amount of economic benefit or savings resulting from the violation.<sup>5</sup>

Recent steep rises in the retail price of gasoline in midwestern RFG areas have resulted in calls by federal, state and local elected officials and gasoline marketers for ameliorative action by the Environmental Protection Agency (EPA) and for the institution of Federal Trade Commission and congressional committee investigations as to whether the increased prices are due to environmental rules, high prices for crude oil, supply disruptions or collusion, or some combination of these factors. Your particular interest at the moment is the nature of any possible actions the EPA may take to temporarily

<sup>1</sup> Pub. L. 101-559.

<sup>2</sup> See generally, CRS Issue Brief IB 10004, *Clean Air Act Issues in the 106<sup>th</sup> Congress*, at pp. 4-6 (CRS Issue Brief).

<sup>3</sup> Codified at 42 U.S.C. 7545 (k) (1994).

<sup>4</sup> 40 CFR Part 80, Subpart D.

<sup>5</sup> 40 CFR 80.79, 80.80.

mitigate the impact on consumers of the price rises in the Chicago/Milwaukee area.

Our review of EPA's authority and recent practice in this area indicates that at least three courses of ameliorative action may be available to the agency, each of which may be subject to issues of practical utility or possible questions of authority, or both. These options are a waiver under Section 211 (k) (2) (B) of the Act; a waiver under 40 CFR 80.73; or an exercise of prosecutorial discretion not to take enforcement action regardless of Section 80.73's applicability for the period required for prices to be stabilized.

Some background on agency use of waivers and judicial approbation of their utilization is useful in assessing the scope and limitations of EPA authority in the area. Judicial precedent has long been strongly supportive of waiver and variance authority of rulemaking agencies as a means of assuring regulated parties of due process.<sup>5</sup> The courts have recognized that rules, by definition, tend to cover a broad range of people and activities and often affect many divergent interests. At times individual and specific activities are regulated by accident or because it was impossible to sort them out, or regulations have unanticipated unfoward effects. In such circumstances courts have found that agency waivers and variances provide a legitimate mechanism for pursuing both fairness and the public interest in particular, individualized cases.<sup>7</sup> As a panel of the District of Columbia Circuit Court of Appeals observed, "waiver processes are a permissible device for fine tuning regulations, particularly where, as here, the Commission must enact policies based on 'informed prediction' .... So long as the underlying rules are rational, as we find them to be here, waiver is an appropriate method of curtailing the inevitable excesses of the agency's general rule."<sup>8</sup>

As a consequence, it has been accepted that rulemaking agencies should provide a reasonable opportunity to petition for individual treatment in the form of waiver, exemption or variance. The source for such a requirement traces back to remarks in Supreme Court rulings in *United States v. Storer Broadcasting Co.*<sup>9</sup> and *National*

<sup>5</sup> See, e.g., *Chemical Manufacturer Association v. Natural Resources Defense Council, Inc.*, 470 U.S. 116, 132-133 and ft. 25 (1985) ("[T]he availability of [EPA's] FDF variances makes bearable the enormous burden faced by EPA in promulgating categories of sources and setting effluent limitations. . . . Unfortunately, EPA will not be appraised of and will fail to consider unique factors applicable to atypical plants during the categorical rulemaking process, and it is thus important that EPA's nationally binding categorical pretreatment standards. . . be tempered with the flexibility that the FPF variance mechanism offers, a mechanism repugnant to neither the goals nor the operation of the Act.")

<sup>7</sup> *American Trucking Associations, Inc. v. Federal Highway Administration*, 51 F.3d 405, 414 (4<sup>th</sup> Cir. 1995).

<sup>8</sup> *National Rural Telecom Association v. FCC*, 988 F.2d 174, 181 (D.C. Cir. 1993).

<sup>9</sup> 351 U.S. 192 (1956).

<sup>10</sup> 319 U.S. 190 (1943).

*Broadcasting Co. v. United States*.<sup>10</sup> Both of those cases appear to uphold the FCC's rulemaking efforts partly because the agency built into its regulatory scheme the flexibility necessary to offer individual treatment to those covered by the rule.<sup>11</sup> Neither case expressly required provision for waiver or variance, but the existence of such opportunity made the Court more comfortable with the rule. *Storer Broadcasting* in particular has been read over the years to support a right to petition for waiver or variance.<sup>12</sup>

The viability of waiver or variance to do individual justice was recognized by the Court in *Chemical Mfrs. Ass'n v. Natural Resources Defense Council, Inc.*<sup>13</sup> The Court noted that EPA had long used a variance process "as a mechanism for ensuring that its necessarily rough-hewn categories do not unfairly burden atypical plants."<sup>14</sup> In the 1977 amendment to the Clean Water Act, however, Congress prohibited the EPA from modifying requirements as to specific toxic pollutants. The NRDC challenged the EPA's continuation of the practice of occasionally granting variances. For several reasons, the Court found sufficient flexibility in both the language and the history of the Act to permit the variances. Since the agency wrote the standards, it appeared reasonable to the Court to assume that it had the inherent power to provide for variance.<sup>15</sup> Nor, the Court found, did the variance process frustrate the legislative intent or work a result inconsistent with the Act's goals.<sup>16</sup> Not compelled then by the Act, its history, or surrounding considerations to strike down the variance procedure, the Court considered the advisability of the variance process in this context. The Court found nothing to forbid "sensible variance mechanisms for tailoring the categories it promulgates."<sup>17</sup>

While most cases involve statutory or regulatory waiver provisions, a number involve the exercise of waiver authority in the absence of such authority,<sup>18</sup> confirming the indication of the Court in *Chemical Mfrs. Association* that rulemaking agencies have inherent authority to provide appropriate waivers.<sup>19</sup>

Also, the courts have made challenging the denial of a waiver a "difficult task."<sup>20</sup>

<sup>10</sup> 319 U.S. 190 (1943).

<sup>11</sup> 315 U.S. at 204-05; 319 U.S. at 225.

<sup>12</sup> E.g., *EPC v. Texaco, Inc.*, 377 U.S. 33, 40-41 (1964); *National Petroleum Refiners Assoc. v. FTC*, 482 F.2d 672, 692 (D.C. Cir. 1973), cert. denied, 415 U.S. 951 (1974).

<sup>13</sup> 470 U.S. 116 (1985).

<sup>14</sup> 470 U.S. at 120.

<sup>15</sup> 470 U.S. at 125-130.

<sup>16</sup> 470 U.S. at 129.

<sup>17</sup> 470 U.S. at 134.

<sup>18</sup> See, e.g., *NTN Bearing Corp. v. United States*, 74 F.3d 1204, 1207 (Fed. Cir. 1995); *MacLeod v. ICC*, 54 F.3d 888, 891 (D.C. Cir. 1995); *National Petroleum Refiners Assoc. v. FTC*, 482 F.2d 672, 692 (D.C. Cir. 1973).

<sup>19</sup> See also, *National Rural Telecom Association v. FCC*, 988 F.2d 174, 181 (D.C. Cir. 1993) ("As this Court has held, waiver processes are a permissible device for fine tuning regulations, particularly where, as here, the Commission must enact policies based on 'informed prediction.' [citation omitted] So long as the rules are rational, as we find them to be here, waiver is an appropriate method of curtailing the excesses of the agency's general rule.")

<sup>20</sup> *MacLeod v. ICC*, 54 F.3d 888, 891 (D.C. Cir. 1985).

A challenger must show that the reasons for denial were so insubstantial as to constitute an abuse of discretion.<sup>21</sup> Although a request for a waiver that is "stated with clarity and accompanied by supporting data" must not be "subject to perfunctory treatment, but must be given a hard look" by the agency,<sup>22</sup> a court will set aside a waiver determination only if it is arbitrary and capricious or contrary to law.<sup>23</sup> Review under this standard is generally deferential to the agency. A court will determine whether the agency has "articulated a satisfactory explanation for its action, including a rational connection between the facts found and the choice made."<sup>24</sup> The agency's decision must be based on the factors made relevant by Congress and must not constitute a clear error of judgment.<sup>25</sup>

Finally, it may be noted that none of the waivers and variances that were the subjects of the above-discussed cases were issued pursuant to notice and comment rulemaking, and no questions were raised by the courts with respect to the informal processes used to make the determinations. This is hardly surprising since, as the case law makes apparent, waivers and variances are intended as vehicles to provide an element of flexibility and fairness in the regulatory process by authorizing the expeditious agency correction of errors or imposition of unanticipated burdens in individual cases, and not to alter the substantive policy of the agency's governing regulation. As the *Chemical Manufacturers* Court observed:

An FDF variance does not excuse compliance with a correct requirement, but instead represents an acknowledgment that not all relevant factors were taken sufficiently into account in framing that requirement originally, and that those relevant factors, properly considered, would have justified--indeed required--the creation of a subcategory for the discharger in question. As we have recognized, the FDF variance is a laudable corrective mechanism, "an acknowledgment that the uniform . . . limitation was set without reference to the full range of practices, to which the Administrator was to refer." [citation omitted] It is, essentially, not an exception to the standard setting process, but rather a more

<sup>21</sup> *MacLeod v. FCC*, *supra*, 54 F.3d at 891; *Florida Cellular Mobil Communication v. FCC*, 28 F.3d 191, 199 (D.C. Cir. 1994), *cert. denied*, 514 U.S. 1016 (1995); *NTN Bearing Corp. v. U.S.*, 74 F.3d 1204, 1207 (Fed. Cir. 1995); *Green County Mobilphone, Inc. v. FCC*, 765 F.2d 275, 238 (D.C. Cir. 1985); *F&R Temmer v. FCC*, 743 F.2d 918, 929 (D.C. Cir. 1984).

<sup>22</sup> *Bellsouth Corporation v. FCC*, 162 F.3d 1215, 1224 (D.C. Cir. 1999); *WALT Radio v. FCC*, 418 F.2d 1153, 1157 (D.C. Cir. 1969).

<sup>23</sup> 5 U.S.C. 706 (2) (1994).

<sup>24</sup> *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1987); *Gilbert v. NTSB*, 80 F.3d 364, 368 (9<sup>th</sup> Cir. 1996).

<sup>25</sup> *Gilbert v. NTSB*, *supra*, 80 F.3d at 368.



*fine-tuned application of it.*<sup>26</sup>

We now turn to EPA's waiver options.

Section 211 (k) (2)(B) of the Clean Air Act requires that the oxygen content of gasoline shall equal or exceed 2 percent by weight but that the "Administrator may waive, in whole or part, the application of this subparagraph for any ozone nonattainment area upon a determination by the Administrator that compliance with such requirement would prevent or interfere with the attainment by the area of a national primary ambient air quality standard."<sup>27</sup> The statutory provision would appear to have virtually no utility in the current situation. The Administrator may waive the oxygen content requirement only upon a finding that enforced compliance would in any particular nonattainment area impede attainment in that area "of a national primary ambient air quality standard." Since there appears no dispute that allowing even the temporary use of conventional gasoline will have the deleterious effects sought to be minimized by RFG requirements, it does not appear that the Administrator could validly make such determination. Indeed, just such a contention has been made in opposition to a petition by the State of California under Section 211 (k)(2)(B) requesting a waiver of the federal oxygenates requirement because the oxygenate it is using, methyl tertiary-butyl ether (MTBE), is contaminating water supplies in the State. Opponents contend that California's proffered ground for the waiver is not a contemplated ground for waiver under the statutory provision. The State's petition, which was filed on March 25 1999, has yet to be acted upon.<sup>28</sup> It would seem, then, that the statutory waiver mechanism is arguably neither an apposite nor expeditious vehicle for resolving the instant situation.

Arguably more promising is the EPA's regulatory waiver provision found at 40 CFR 80.73 which permits the issuance of waivers which would allow the distribution of gasoline "for a brief period" which does not meet the requirements for reformulated gasoline in appropriate "extreme and unusual circumstances" that "could not be avoided by the exercise of prudence, diligence and due care." If such extraordinary circumstances are found to obtain, the Administrator then must (1) make a finding that it is in the public interest to waive the requirement; (2) make a finding that the refiner, importer, or oxygenate blender exercised due diligence and still was not able to avoid the nonconformance; (3) the petitioners must show how they will expeditiously achieve the RFG requirements; (4) the petitioners must agree to make up the air quality detriment that has been caused, "where practicable;" and (5) EPA must assure that no windfall accrues to any refiner, importer or oxygenate blender by requiring them to pay into the U.S.

<sup>26</sup> *Chemical Manufacturers Association v. EPA*, *supra*, 470 U.S. at 136 (emphasis supplied).

<sup>27</sup> CRS Issue Brief, *supra*, at 4-5.

<sup>28</sup> **§80.73 Inability to produce conforming gasoline in extraordinary circumstances.**

In appropriate extreme and unusual circumstances (e.g., natural disaster or Act of God) which are clearly outside the control of the refiner, importer, or oxygenate blender and which could not have been avoided by the exercise of prudence, diligence, and due care, EPA may permit a refiner, importer, or oxygenate blender, for a brief period, to distribute gasoline which does not meet the requirements for reformulated gasoline, if:

(a) It is in the public interest to do so (e.g., distribution of the nonconforming gasoline is necessary to meet projected shortfalls which cannot otherwise be compensated for);

Treasury an amount equal to the economic benefit resulting from the nonconformity minus the amount expended to make up for the air quality detriment.<sup>28</sup>

While the regulatory waiver provision appears to be a more viable vehicle for the present situation, the EPA has until recently followed a third, arguably more problematic course of action. To achieve the effect of a waiver the agency announced in dealing with RFG supply shortages in the St. Louis area that it would "exercise enforcement discretion," i.e., it would not act to impose and enforce nonconformance penalties during a specified period when conventional gasoline would be brought into the area. The conditions imposed by EPA for its prosecutorial forbearance between March 17 and May 5, 2000, as detailed in letters from EPA, did not conform with the requirements of Section 80.73, particularly with regard to the avoidance of windfall profits. Thereafter, until June 19, 2000, windfall profit conditions gradually became more explicit. The chronology is as follows.

On March 17, 2000, the EPA's Assistant Administrator for Enforcement and Compliance, apparently responding to a request from the Missouri Petroleum Marketers and Convenience Store Operators, acknowledged that there was a RFG supply disruption in the St. Louis area caused by a pipeline leak and that the Department of Energy had advised EPA that RFG supplies would be inadequate until early April. In light of the situation, the Enforcement Office announced that effective immediately it would exercise enforcement discretion and would enforce the RFG requirements as follows:

Distributors may receive deliveries of conventional gasoline into terminal tanks normally used to store RFG provided the volume of conventional gasoline is no greater than the volume necessary to supply the terminal's demands through April 3, 2000. Distributors may continue to deliver gasoline from such a tank to facilities in the St. Louis covered area subsequent to April 3 if the tank has received a delivery of RFG.

Distributors may deliver conventional gasoline to retail outlets and wholesale purchaser-consumer facilities (facilities) in the St. Louis covered area. This category of enforcement discretion expires on April 3, 2000.

(b) The refiner, importer, or oxygenate blender exercised prudent planning and was not able to avoid the violation and has taken all reasonable steps to minimize the extent of the nonconformity;

(c) The refiner, importer, or oxygenate blender can show how the requirements for reformulated gasoline will be expeditiously achieved;

(d) The refiner, importer, or oxygenate blender agrees to make up air quality detriment associated with the nonconforming gasoline, where practicable; and

(e) The refiner, importer, or oxygenate blender pays to the U.S. Treasury an amount equal to the economic benefit of the nonconformity minus the amount expended, pursuant to paragraph (d) of this section, in making up the air quality detriment.

- Distributors may receive deliveries of conventional gasoline into terminal tanks normally used to store RFG provided the volume of conventional gasoline is no greater than the volume necessary to supply the terminal's demands through April 3, 2000. Distributors may continue to deliver gasoline from such a tank to facilities in the St. Louis covered area subsequent to April 3 if the tank has received a delivery of RFG.
- Beginning on April 3, 2000, only RFG may be delivered to terminals that supply facilities in the St. Louis covered area.
- Beginning on May 1, 2000, the gasoline at terminals that supply facilities in the St. Louis covered area must meet all applicable RFG standards including the VOC emissions control standards, and these standards will not be enforced at terminals until this date.
- Beginning on June 1, 2000, the gasoline at retail outlets and wholesale purchaser-consumer facilities in the St. Louis covered area must meet all applicable RFG standards including the VOC emissions control standard, and these standards will not be enforced at these facilities until this date.

The letter makes no reference to Section 80.73 or the conditions and findings that are required by that regulation for approval of a waiver.

On April 3, 2000, the EPA Enforcement Office advised the Missouri Petroleum Marketers that because the anticipated shipments of RFG would not be available as anticipated, the "enforcement discretion relief" under the conditions described in its March 17, 2000 letter would be extended to April 5. On May 5 the continued inadequacy of supplies led EPA to again extend the nonenforcement period to May 8. This time, however, the agency added the following penalty provision: "Each distributor supplying conventional gasoline to the St. Louis covered area under the terms of this enforcement discretion is subject to a penalty of \$0.15 per gallon for every gallon of conventional gasoline distributed to the RFG area during the period of this enforcement discretion." EPA also imposed two additional conditions:

1) A distributor who has RFG supplies must supply RFG instead of conventional gasoline, and if RFG is made available to other distributors these other distributors must use reasonable efforts to distribute RFG instead of conventional gasoline. However, a distributor supplying gasoline to a retail outlet that has been selling RFG containing MTBE is not required to supply RFG containing ethanol to such retail outlet; and

2) Any distributor who distributes conventional gasoline in the St. Louis covered area under this enforcement discretion explicitly agrees to be subject to the penalty provision above, and agrees to provide EPA

sufficient information to determine the appropriate penalty amount. Any party who does not comply with these conditions will be liable for violating Section 211 of the Clean Air Act and the RFG regulations at 40 CFR Part 80.

The reference to 40 CFR Part 80 is the first, albeit oblique, mention of the waiver provision.

On May 18, 2000 EPA again acknowledged that shortages would continue until mid-June. As a consequence EPA encouraged use of conventional gasoline but advised that if the shortages continued after June 5, "EPA intends to condition [continued] relief on the payment of penalties that are sufficiently large to create a *significant disincentive to distribute conventional gasoline* instead of RFG." (emphasis in original). EPA also announced that if the shortage continued beyond June 5, all parties distributing conventional gasoline after that date had to sign a Compliance Agreement in which they agreed to "pay to the U.S. Treasury penalties that will be specified at the time the regulatory relief is granted. The size of those penalties will be sufficiently large to at least reflect the benefit gained by substituting conventional gasoline for RFG." EPA again reverted to the exercise of enforcement discretion as the basis of its authority, but made no direct reference to Section 80.73. The nonenforcement period ended on June 19, 2000.

In May 2000, the EPA received requests from the Petroleum Marketers Association of Wisconsin to provide "enforcement discretion" for the requirement to use RFG in the Milwaukee metropolitan area because of the steep increases in the retail cost of RFG. Exercise of enforcement discretion was denied on May 26, 2000 on the ground that there were adequate supplies in the area and that the anticipated shutdown of a pipeline supplying the area would not cause a shortage. EPA also approvingly referenced a communication from the American Petroleum Institute which stated that "issuance of petroleum waivers injects uncertainty into the market and could lead to higher gasoline prices," as well as assurances from distributors that adequate supplies of RFG would be available in the area. EPA noted the health benefits that accrue as a result of the use of RFG and then distinguished its exercise of prosecutorial discretion in St. Louis as follows:

Given these compelling health benefits from RFG, it is EPA's position that the RFG requirements should be waived only in an extraordinary situation. The RFG regulations provide that relief may be appropriate in extreme and unusual circumstances, such as a natural disaster or an Act of God which clearly is outside the control of the regulated party. For example, the recent regulatory relief granted in St. Louis, described below, was the result of a catastrophic, unexpected situation that could not have been avoided by the exercise of prudence, diligence and due care.

On May 18, 2000, EPA granted regulatory relief for the St. Louis metropolitan area allowing use of

conventional gasoline through June 5. The RFG supply situation in St. Louis, however, was significantly different than in Milwaukee. The supply problem in St. Louis resulted when the Explorer Pipeline experienced a break on March 10, 2000, that forced it to shut down completely for five days and to operate at less than full capacity until September or October of this year. Most of the gasoline used in St. Louis is transported by the Explorer Pipeline. As a result of this unexpected, ongoing supply interruption, most terminals supplying gasoline to St. Louis were out of RFG altogether when relief had not been granted retail stations there would have had no gasoline. The relief will allow RFG supplies to build, so that sufficient RFG will be available to supply the St. Louis market for the remainder of the summer high ozone season.

Thus, retrospectively EPA appears to be describing a situation that would have triggered Section 80.73. However, their actual communications and actions in the matter at the time seemed to ignore the specific findings that had to be made and the conditions that had to be imposed in order to grant an 80.73 waiver. For example, EPA did not impose a windfall profits recovery requirement until very late in the process.

EPA's initial use of "enforcement discretion," or prosecutorial discretion as it is more commonly known, without regard to Section 80.73's specific requirements, may have been legally problematic. EPA may have believed that its action conformed with the Supreme Court's ruling in *Heckler v. Chaney*,<sup>29</sup> where the Court held that the decision to initiate or not initiate a proceeding was within the unreviewable discretion of the agency. That case involved the refusal by the Food and Drug Administration (FDA) to review drugs used to carry out the death penalty as "safe and effective" for human executions. The Court found that FDA possessed the kind of broad discretion under the Administrative Procedure Act that is unreviewable because there is "no law to apply." The Court noted the traditional reluctance of courts not to second guess agency decisions not to enforce given an agency's expertise, and better understanding of its enforcement policies and available resources.<sup>30</sup> It also stated that "[t]his Court has recognized on several occasions over many years that an agency's decision not to prosecute or enforce, whether through civil or criminal process is a decision generally committed to an agency's absolute discretion."<sup>31</sup> This was also reflective of the Court's further recognition "that an agency's refusal to institute proceedings shares to some extent the characteristics of the decision of a prosecutor in the Executive Branch not to indict -- a decision that has long been regarded as the special province of the Executive Branch, inasmuch as it is the Executive who is charged by the Constitution to "take care that the laws be faithfully executed."<sup>32</sup>

<sup>29</sup> 470 U.S. 714 (1985).

<sup>30</sup> 470 U.S. at 831-32.

<sup>31</sup> *Id.* at 831.

<sup>32</sup> *Id.* at 832.

But the Court also emphasized, however, that the presumption of unreviewability of inaction is rebuttable.<sup>33</sup> In that case the Court recognized that Congress can delineate and otherwise circumscribe an agency's discretion. Subsequent case law interpreting and applying *Chaney* have found that agency rules implementing statutory directives may create one or more mandatory, justiciable standards. See, e.g., *McAlpine v. United States*, 112 F.3d 1429 (10<sup>th</sup> Cir. 1997) (Department of Interior decision declining to acquire land in trust for Indians held subject to judicial review in light of an agency rule that the agency "shall" consider seven factors in making such a decision which thereby provided "law to apply."); *Greater Los Angeles Council on Deafness v. Baldrige*, 827 F.2d 1353 (9<sup>th</sup> Cir. 1987) (an agency's rule obligating itself to investigate every complaint alleging violation of a statute and to inform complainant of its reason for declining an enforcement action in response to a complaint held to provide "law to apply."); Such rulings are reflective of the long established doctrine that agencies are bound to obey their own legislative rules. See, e.g., *Accardi v. Shaughnessy*, 347 U.S. 260 (1954); *Service v. Dulles*, 354 U.S. 363 (1957); *Mine Reclamation Corp. v. FERC*, 30 F.3d 1519, 1524 (D.C. Cir. 1994).

40 CFR 80.73 is arguably such a binding rule and the failure of EPA to follow its terms during the first several months of the St. Louis situation would likely be held to be subject to judicial review although we would not speculate on the outcome of such a challenge. Arguably, however, the continued utilization of "enforcement discretion" by EPA rather than applying the prescriptions of Section 80.73 casts doubt as to the legal substantiality of both grants and denials of waivers (or their equivalents). Thus while the factual distinctions made by EPA between the St. Louis and Milwaukee situations may be both sound and persuasive, the uncertainty of the legal basis for those decisions leaves a cloud of doubt for future similar situations.

In summary, then, it would appear that Section 80.73 is, in the words of *Heckler*, the "law to apply" and that the use of prosecutorial discretion may be legally problematic. Thus, the regulation would appear to be the sole viable vehicle by which EPA might provide waiver relief for situations like St. Louis or Chicago/Milwaukee.

<sup>33</sup> *Id.* at 833.

## EXHIBIT XIX

PIRINC Study: "Gasoline 101: A Politically Explosive Topic", June 2000

This Petroleum Industry Research Foundation, Inc. report focuses on the factors contributing to the gasoline price increases both nationally and in the Midwest. Higher crude oil prices, low stocks, and problems introducing new, more stringent, Phase 2 reformulated gasoline inhibited domestic production and imports. Transportation disruptions and the blending of ethanol contributed to the price spikes. As these problems are overcome, prices begin to moderate but the system will continue to be volatile until inventories are rebuilt.



**You may be interested.**

PIRINC has prepared the enclosed report, *Gasoline 101: A Politically Explosive Topic*.

Few subjects attract as much public outcry as rising gasoline prices. The past several weeks have seen both, especially in certain areas of the Mid-West. As has happened before, there have been numerous calls for investigations of industry price "gouging." A significant increase in US gasoline prices was inevitable, given the worldwide increase in crude oil prices since early last year. But the gasoline price increases exceeded the increase in crude prices, adding to public concern that prices are, in the words of one public official, "unfair and inappropriate."

This report focuses on the factors contributing to the gasoline price increases both nationally and in the most severely impacted parts of the Mid-West. Apart from higher crude prices and low stocks, other domestic factors include the problems associated with the introduction of more stringent, Phase II reformulated gasoline. These have inhibited both domestic production and imports. The UNOCAL patent infringement case further inhibited supply. Disruptions to the logistics system, notably pipelines serving the Mid-West, and problems of blending ethanol as opposed to MTBE in making Phase II gasoline contributed to price spikes in parts of the Mid-West. Each of these domestic factors individually had only a minimal impact. But together, they produced a noticeable shortfall in supply of an extremely price inelastic product and therefore a sharp increase in gasoline prices. As these problems are overcome, prices are already beginning to moderate. However, until inventories are rebuilt, the system remains vulnerable.

If you have any questions or comments, please call John Lichtblau, Larry Goldstein or Ron Gold.

---

Petroleum Industry Research Foundation, Inc.  
3 Park Avenue • 26<sup>th</sup> Floor • New York, NY 10016-5989  
Tel.: (212) 686-6470 • Fax: (212) 686-6558



### Gasoline 101: A Politically Explosive Topic

Few subjects attract as much public outcry as rising gasoline prices. The past several weeks have seen both, especially in certain areas of the Mid-West. In mid-June, the U.S. average gasoline price was up by about 50 cents/gallon versus the same time last year (\$1.66 versus \$1.15/gallon) with about 20 cents of the increase coming since the beginning of May. The overall averages conceal some very wide geographic disparities. On the East Coast (PADD 1) the year-on-year increase in gasoline prices averaged about 47 cents a gallon while in the Mid-West (PADD 2), the increase averaged 71 cents, and in reformulated areas, 85 cents/gallon.<sup>1</sup> These gasoline price increases far exceeded the increase in crude prices, which went up by 33 cents a gallon versus mid-June, 1999. As has happened on previous occasions, there have been numerous calls for investigations of industry price "gouging," including a request by Clinton Administration for an expedited review of price developments by the Federal Trade Commission.

This note focuses on the factors contributing to the gasoline price increases both nationally and in the most severely impacted parts of the Mid-West. Many commentaries have made the point that the price increases, especially in Chicago and Milwaukee, have far exceeded the apparent costs of producing the new Phase 2 reformulated gasoline required this year under EPA mandate. This discrepancy is then cited as evidence that prices are "unfair and inappropriate."<sup>2</sup> But while costs are important, price in the short term is determined by the interaction between supply and demand. Price serves a critical function in a competitive market, namely adjusting demand to accommodate changes in supply conditions. When price is not allowed to play this role, the result is long lines at the pumps, rationing, or outright shortage. Consumers require a relatively stable amount of gasoline for their normal routines, with limited possibilities for using less when the price goes up and not much reason to use more when the price goes down, especially in the near-term. Thus, in economic terms, demand for gasoline, a necessity for most consumers, has a very low near-term price elasticity. As a result, the price adjustments tend to be disproportionately large.<sup>3</sup> Over time however, history shows that they are also self-correcting.

There are several identifiable factors that contributed to the run-up in prices. These include the rise in world crude prices and low world stocks resulting from OPEC's production decisions. Within the U.S. interrelated problems associated with the introduction of more stringent, Phase II reformulated gasoline this year inhibited both domestic production and imports. The UNOCAL patent infringement case further inhibited supply. Disruptions to the logistics system, notably pipelines serving the Mid-West, and problems of blending ethanol as opposed to MTBE in making Phase II gasoline contributed to even sharper price increases in the Mid-West than

<sup>1</sup> RFG areas are ozone non-attainment areas where reformulated gasoline is required. Note the sharp price increases in the Mid-West RFG areas, especially Chicago and Milwaukee did not occur in other regions. In PADD 1, prices in RFG areas went up by about the same 47 cents/gallon as the overall average for the region since mid-June 1999.

<sup>2</sup> "We think the prices that are being charged are unfair and inappropriate," Robert Perciasepe, assistant administrator at the Environmental Protection Agency, as reported by Reuters on June 13.

<sup>3</sup> That is to say, a relatively large change in price is required to elicit a small change in demand. For example, if price elasticity = -0.1, a 10% increase in price reduces demand by only 1%. If price elasticity = -1 (called unit price elasticity) demand would be reduced about in proportion to the price change. The price elasticity for gasoline in the very near term is even smaller than -0.1, as is discussed later in the note.



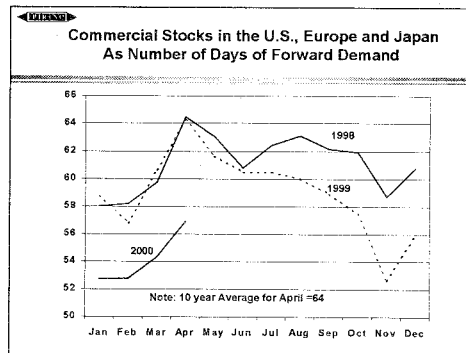
### Gasoline 101: A Politically Explosive Topic

elsewhere. Apart from the increases in crude prices, and the exceptionally low level of stocks, both globally and within the U.S., none of the other factors by themselves would have had more than a minimal impact. But together, they produced a noticeable shortfall in supply of an extremely price inelastic product and a sharp increase in gasoline prices. As production and logistics problems are overcome, prices will moderate, indeed this is already happening. However, until inventories are rebuilt, the system remains vulnerable.

### Global and National Considerations

A significant increase in US gasoline prices was inevitable, given the world-wide increase in crude oil prices that began early last year. From its low-point of about \$12/barrel, or 29 cents/gallon, in February of last year, the price of WTI rose to nearly \$18 (or 43 cents/gallon) by June 1999, and has since risen further to \$32 (or 76 cents/gallon) as of mid-June of this year. Another key element influencing prices is the exceptionally low levels of inventories in the US and elsewhere.

The chart on the right shows commercial oil stocks for the three major OECD consuming regions, the U.S., Europe and Japan. Stocks are measured in terms of days of forward, or anticipated, demand that they would cover and are shown by month since the beginning of 1998. In 1998 and through early 1999, stocks were at extremely high levels. April stocks for both years amounted to just over 64 days of forward demand, well above the 1995-2000 average of 61, and higher than any year since 1993. These high inventories were a major depressing influence on the world oil market. OPEC's decisions in March 1998, June 1998, and March 1999 to cut production were designed to bring down inventories and thereby strengthen the world crude market. The first two production cuts were overwhelmed by the reductions in demand resulting from the fall-out of the Asian financial crisis and recession. But the third, coming at a time of economic recovery in Asia and improved growth elsewhere, has had the intended effect. Since March of last year, commercial stocks in the main OECD regions have moved sharply lower. Indeed, stocks so far this year are running at historically low levels.



The extremely low level of stocks has not only helped push up prices, as OPEC originally intended, but has also left the world oil market without the cushion of high inventories and therefore extremely vulnerable to any supply interruptions, or sudden surges in demand. While OPEC intended crude oil prices to move up, it has become concerned about the extreme vulnerability of the market, and has moved to raise official production ceilings, first in March of this year, and again this month. Nonetheless, it will take time for inventories to be rebuilt to "normal" levels and a market safety margin re-established.

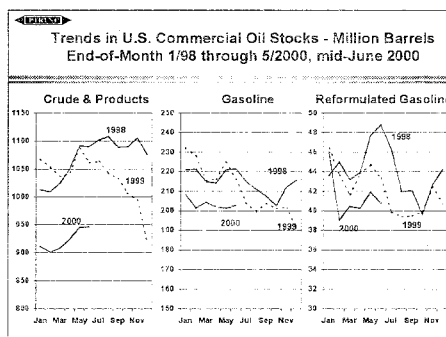
## Gasoline 101: A Politically Explosive Topic

## U.S. Inventory Levels

The specific U.S. inventory situation also shows exceptional tightness, both overall and for the product currently in the headlines, gasoline. The chart below shows commercial inventory levels since January 1998 for total crude and products, gasoline, and reformulated gasoline. Figures are in millions of barrels.

The left panel shows the trends for crude and products. By the end of 1999, total commercial stocks had fallen by 15% relative to their end-1998 level. There has been only minimal improvement since then. As of mid-June, total stocks were over 100 million barrels, or 11%, below year-earlier levels.

The middle panel shows the trends for total gasoline. These stocks have been running about 10% below year-earlier levels with no sign of any significant spring build as occurred in the prior years. The situation for reformulated gasoline, which accounts for about 30% of total gasoline sales, is shown in the right panel. Stocks at the beginning of the year were similar to levels in 1998-99 but fell sharply in February with only a marginal recovery since that low-point. The new Phase II standard came into effect on May 1, except at the retail level where the deadline was June 1.<sup>4</sup> The run-down in inventories started at the beginning of the year in anticipation of the changeover to the new standard. The problem has been the insufficient build-up of the new Phase II product. Mid-June stocks are 6% below the June 1999 level and 16% below their June 1998 level despite the fact that demand is up.



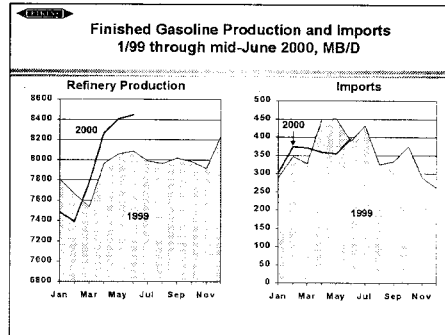
## Trends in U.S. Gasoline Supplies

Low gasoline stocks mean there has been minimal flexibility to meet unanticipated supply/demand developments—which have indeed occurred. A year ago, the Department of Energy, in its June 1999 Short-Term Energy Outlook, projected about a 2% growth in gasoline demand for 2000 versus 1999 and an average retail price of \$1.20/gallon. The 2% figure was reasonable given their moderate price assumption and anticipated economic growth of 3.6% for 1999 decelerating to 1.7% this year. Gasoline stocks were assumed to remain about level. Implicitly, supplies of gasoline from domestic and foreign refineries were assumed to grow in line with projected demand. However, this did not happen. The chart below summarizes trends in refinery production and imports.

<sup>4</sup> January 2000 was the first month in which Phase II standards applied to gasoline production and imports, although effectively, since the oxygenate and benzene standards were unchanged, the program impacted the supply chain when the more severe summer VOC standard came into effect.

## Gasoline 101: A Politically Explosive Topic

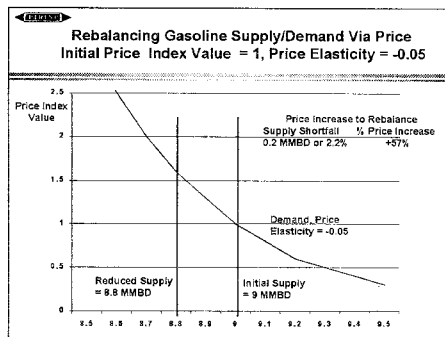
The panel on the left shows refinery production of finished gasoline. Since February, production has been running above 1999 levels. For the year to date, production is up about 100 MBD versus 1999, an increase of about 1.5%. The panel on the right shows imports of finished gasoline. Since February, imports have been running below 1999 levels. For the year to date, imports are running about 15 MBD below year-ago levels, a decline of about 4%. Total supplies of finished gasoline from domestic production and imports are up only about 1% or about 85 MBD so far this year--about 1% below demand as anticipated by the Department of Energy last year. Moreover, economic growth has been much stronger than anticipated. GDP growth this year in the latest Short-Term Energy Outlook is now projected at 4% (other outside forecasters are projecting still higher growth, 5%), well above their projection made a year ago. The much higher projection indicates that, in the absence of the sharp price increases seen this year, demand growth would have been well above the 2% rate.



## Implications of a Low Price Elasticity

As noted earlier, consumers find it extremely difficult to cut back their normal use of gasoline for commuting, shopping, vacation travel, etc., especially in the short-term. Since gasoline is therefore price inelastic, price increases tend to be disproportionately large for what appear to be very modest shortfalls in supply. A reasonable estimate, in line with recent experience, would place the short-term price elasticity for gasoline at about  $-0.05$ . The implications of such a low figure are illustrated in the chart below.

The chart shows a downward sloping demand curve with a constant price elasticity of  $-0.05$  intersecting an initial supply curve fixed at 9 MMB/D at a price index value of 1.0.<sup>5</sup> If supply is suddenly reduced to 8.8 MMB/D, a decline of 2.2% from its initial level, the price has to rise by nearly 60% to clear the market.<sup>6</sup> For the week ending June 19, the Department of Energy



<sup>5</sup> Last year gasoline demand for June through August was about 8.8 MMB/D. A 2% increase for 2000 would raise demand to about 9 MMB/D. Supply is production plus imports plus stock change.

<sup>6</sup> For an 0.1 MMB/D or 1.1% reduction in supply, the price increase would be 25%. For an 0.3 MMB/D loss of supply, or 3.3%, the price would have to double to clear the market.

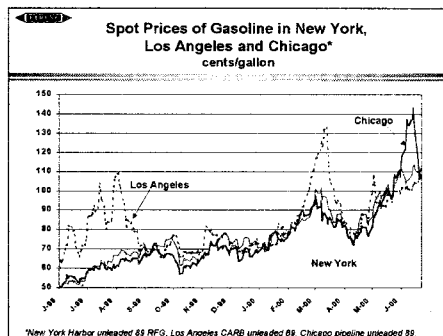
### Gasoline 101: A Politically Explosive Topic

reports U.S. gasoline prices averaging about \$1.70/gallon, up 56 cents, or about 50% from their average a year ago. This is approximately the increase required at the national level to offset a shortfall in anticipated supplies of about 2% given the low estimated price elasticity of gasoline

The 2% figure is about in line with estimates of short-term supply losses (2 to 3%) arising from the impact of the more severe RVP requirements for Phase II gasoline, the effects of the UNOCAL patent infringement judgement on refiners and blenders, and the more limited availability of imports. These problems apply only to summer specifications for reformulated gasoline and will not apply to supplies after September 15.

### Regional Price Disparities: Mid-West Consumers Paying California Prices

So far, the discussion has focused on national trends but this year in Chicago and Milwaukee, and last year in California, the public has been concerned about local price spikes in excess of the national trends. The chart on the right shows daily movements since last June in spot prices for gasoline in New York, Los Angeles, and Chicago. The prices used are the New York harbor price for reformulated unleaded 89 octane, Los Angeles CARB (reformulated) 89 octane, and Chicago unleaded (nonreformulated) 89 octane. At this time last year, spot prices in Los



Angeles were running far above New York and Chicago prices, with differentials exceeding 40 cents/gallon at their peak. Los Angeles also experienced a very brief, price spike again this year in March. Recently, Los Angeles prices have been at or slightly below New York levels. Until nearly the end of May, Chicago spot prices tended to run slightly below the New York prices. But toward the end of the month a substantial differential opened up as Chicago prices rose to peaks in the second week of June roughly 30 cents/gallon above New York prices. They have subsequently declined, slipping below New York prices as of June 21. However, these price movements don't fully capture the price developments in the Chicago area.

The Chicago prices shown are for nonreformulated unleaded regular gasoline while prices shown for New York and Los Angeles are for reformulated gasoline. Chicago (and Milwaukee as well) is an ozone nonattainment area as designated by the EPA and is required to use reformulated gasoline. Both Chicago and Milwaukee use a reformulated gasoline with ethanol as the oxygenate, as opposed to MTBE, generally used elsewhere in the country. Because ethanol is not a petroleum product, it must be segregated from other gasoline components up to the rack, the point just before delivery to the pump. At that point it is added to a reformulated gasoline blendstock for oxygenate blending---or RBOB---specially formulated to be used with ethanol. RBOB accounts for about 90% of the total volume of a gallon of reformulated gasoline made with ethanol. The spot price of Chicago RBOB is typically about the same as the price of

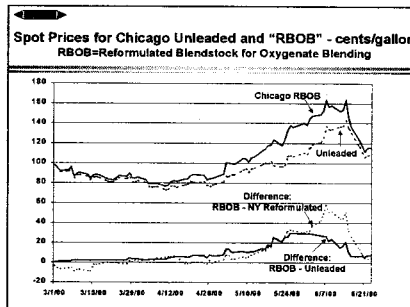
## Gasoline 101: A Politically Explosive Topic

unleaded regular shown in the chart above. But this year has been very different. As shown in the chart below, in early March of this year, Chicago spot price of RBOB was almost identical to the price of the unleaded regular. By mid-April, the differential had widened to about 5 cents/gallon and by early May, 10 cents. By late May into early June, the differential reached about 30 cents/gallon. Since then, the differential has fallen back to about 7 cents.

The dotted line toward the bottom of the chart shows the differential between the spot price of Chicago RBOB and New York reformulated unleaded. In early June, the differentials peaked at nearly 60 cents/gallon. As of late June, the differential is down to about 4 cents/gallon.

## Retail Price Developments

For consumers, the sharp rises in spot prices for ethanol-based reformulated have meant exceptionally sharp increases in pump prices in Chicago and Milwaukee. The table below shows pump prices for unleaded regular in Chicago, Milwaukee, selected other Mid-West cities, as well as Los Angeles and New York for June 9, 1999, March 29, 2000 and June 7, 2000.<sup>7</sup> The left three columns show actual prices while the three right columns show price changes between the periods. The Mid-West cities are shown in descending order of the June 1999 to June 2000 price changes. Between June 1999 and March of this year, the pump price increases for the Mid-West cities shown ranged between 30 and 42 cents/gallon, with neither Chicago nor Milwaukee standing out. Note the exceptionally low price change for Los Angeles, a result of the price surge the year earlier in California as a result of supply problems discussed below.



		6/9/99	3/29/00	6/7/00	6/99 to 3/00	3/00 to 6/00	6/99 to 6/00
Chicago	RFG area	126.8	164.7	210.9	37.9	46.2	84.1
Milwaukee	RFG area	115.4	149.2	191.8	33.8	42.6	76.4
Louisville	RFG area	108.3	145.2	170.4	36.9	25.2	62.1
Cleveland		106.8	149.2	164.9	42.4	15.7	58.1
Detroit		111.5	147.5	161.8	36	14.3	50.3
Kansas City		107.3	138.5	157.3	31.2	18.8	50
Indianapolis		112.4	150.6	159.6	38.2	9	47.2
St. Louis*	RFG area	109.9	140	156.2	30.1	16.2	46.3
Minn.-St. Paul		118.4	150	160.5	31.6	10.5	42.1
Los Angeles	RFG area	141.6	155.4	163.6	13.8	8.2	22
New York	RFG area	133.5	159.1	169.5	25.6	10.4	36

\* Temporary waiver granted in June due to pipeline problems.

<sup>7</sup> Prices are for self-service unleaded as published in the *Oil & Gas Journal*.

### Gasoline 101: A Politically Explosive Topic

The pattern of price changes is very different for March-June of this year. Chicago and Milwaukee show by far the largest price increases, up 46 and 43 cents/gallon respectively. Louisville, another RFG area is next with an increase of 25 cents. Elsewhere the price increases ranged from 8 to 16 cents.

It is precisely these large local price spikes at the pump that trigger public anger, confusion, and demands for investigations. Of course, if gasoline were a uniform, fungible, easily transportable product, then in a competitive market such large spikes should not occur---and if they did, the public would have every reason to be suspicious about just how competitive the market really is. But the problem is that regulatory developments have made gasoline less uniform, or fungible, and more difficult to transport, thereby reducing the ability of the supply system to respond quickly to threats of shortage. As is discussed below, the most vulnerable areas of the country to this problem, and therefore price spikes, are the two that have had them, California and Chicago-Milwaukee.

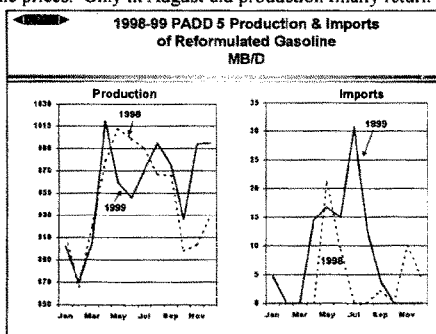
### The "Islands" of California and Chicago-Milwaukee

Although California and the Chicago-Milwaukee sections of the country are geographically very different, with respect to gasoline, they are both "islands," dependent primarily on local sources for supply and very difficult to reach from elsewhere. Their isolation from the rest of the country is the result of their dependence on "boutique" fuels, not readily available elsewhere.

#### California

California has imposed more severe requirements for reformulated gasoline than the rest of the country. In 1999, a series of refinery problems reduced production at a time of rising local demand. The left panel of the chart on the right shows monthly trends in PADD 5 production of reformulated gasoline in 1998 and 1999. In May and June of 1999, production was down by about 50 MBD or about 5% from the year before. This was the period in 1999 of the sharpest spikes in spot Los Angeles CARB gasoline prices. Only in August did production finally return to about year-earlier levels, and in November-December significantly exceed 1998 levels. (New refinery problems in March of this year resulted in temporary production losses and the price spike that occurred at the same time.)

Refiners elsewhere in the world have some limited capability to make CARB standard reformulated although those that do so must take into account the time and cost required to ship the product to California as well as the additional cost of making it.<sup>8</sup> As shown



<sup>8</sup> For U.S. refiners, an additional cost element is the requirement to use U.S. flag ships.

## Gasoline 101: A Politically Explosive Topic

in the left panel of the chart, imports of reformulated gasoline into PADD 5 did indeed move up, reaching a peak of 30 MBD in July versus none the year before. The higher imports, coming from as far away as Finland and Asia, moderated the price spike but only a return to normal refinery operations brought it to an end.

## Chicago and Milwaukee

Chicago and Milwaukee are "islands" for a different reason, their use of ethanol as the oxygenate for reformulated gasoline. This year, Phase II reformulated gasoline requirements came into effect. While the introduction of Phase II gasoline began in January at the refinery level, the more critical summer standard (with lower VOC emissions) did not apply until May 1, or in the case of retail facilities, June 1. At the national level, the more severe requirements had certain particular consequences, especially on availability of imports. So far this year, U.S. total production of reformulated is slightly above last year's levels, but imports are down. The table on the side summarizes the key figures. Production for the first 6 months of this year (more precisely, production through June 16th) has been averaging 12 MBD above year-earlier levels, a growth rate of only 0.5%. Imports, however, are down 28 MBD over the same period, indicating some loss of ability to supply the reformulated product under the new, more severe standards.

In its Fact Sheet on Reformulated Gasoline issued in November, 1999, the EPA estimated that additional costs of phase II reformulated would be on average about 1 to 2 cents/gallon more than Phase I, with costs somewhat higher for some parts of the country and some refiners.<sup>9</sup> The Fact Sheet went on to state:

U.S. Production and Imports of Reformulated Gasoline, 1 <sup>st</sup> 6 months 2000 vs. Year Earlier MBD		
	2000	1999
Production	2,532	2,520
Imports	172	201

"It is not possible to accurately predict the retail price of Phase II RFG in the year 2000 because it will be influenced by many factors including production costs, weather, crude oil prices, taxes and local and regional market conditions. It is important to note that, at the start of the Phase II RFG program, retail prices may be higher or fluctuate more."

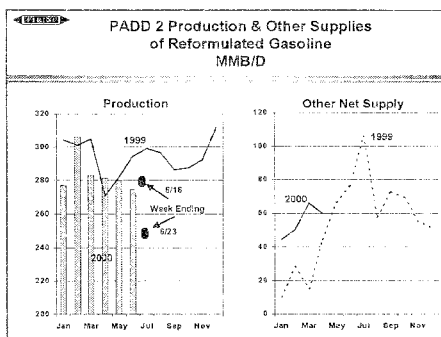
Clearly this was indeed the case for Chicago and Milwaukee, where "local and regional market conditions" were particularly adverse. Chicago and Milwaukee are the principal areas in the Mid-West required to use reformulated gasoline. St. Louis voluntarily opted in to the program in 1999 but received a temporary waiver in June in the face of significant loss of supplies due to problems with the Explorer pipeline. The Cincinnati and Louisville areas also opted into the program but have had no comparable supply difficulties. Even though Chicago and Milwaukee are far away from other consuming centers, this alone would not account for their problems. After all both are ports and of course Chicago is a major rail, road, and pipeline center. But they are unique in their reliance on ethanol as the oxygenate for reformulated gasoline. When it turned out to be more difficult than anticipated to make the ethanol-based Phase II product, there was no where else to turn for immediate relief. Ethanol-based reformulated requires a unique

<sup>9</sup> The complete Fact Sheet may be accessed on the internet at [www.epa.gov/oms/f99040.htm](http://www.epa.gov/oms/f99040.htm). The underlining is PIRINC's

## Gasoline 101: A Politically Explosive Topic

blendstock (RBOB) generally not made elsewhere, and any MTBE-based reformulated gasoline could not be co-mingled with the local supply and therefore could not be moved through normal distribution channels.

Specific supply figures for Chicago and Milwaukee are not available, but overall figures for PADD 2 indicate what has happened. The chart below summarizes supply conditions for reformulated in PADD 2. The panel on the left shows local monthly production of reformulated for 1999, the solid line, and 2000 through June, the bars, with June represented by production through mid-month. In general, production has been running below year-earlier levels, with shortfall especially noticeable in June, the start of the Phase II program at the retail level. The most recent data for the weeks ending June 16 and June 23, show no consistent improvement. So far this year, PADD 2 production of reformulated gasoline is running about 3% below year-ago levels. This is different from the national situation where production is slightly above year-ago levels. For the June to date, the situation is much worse, with production in PADD 2 running about 7% below June 1999 levels.



In principle, a shortfall in local PADD 2 production could be moderated, or even eliminated by increased supplies from other sources, imports, stocks, or shipments from other regions of the country. In reality, imports of reformulated gasoline are virtually zero and stocks are typically very low, in the 1 to 2 million barrel range, or about 2 to 4% of the U.S. total reformulated stocks, well below the PADD 2 share, about 10%, of U.S. total reformulated demand. The absence of imports and low stocks of reformulated gasoline are consistent with a disproportionate reliance on ethanol, since problems of co-mingling severely limit prospects for imports and make holding of the finished product difficult. The panel on the right shows trends in net supply of reformulated gasoline excluding local production. By default, the figures reflect almost exclusively shipments from elsewhere in the country, primarily PADD 3. The latest data available are only for April of this year. Early in the year, shipments were running well ahead of year-earlier levels. But shipments fell back in April to year-earlier levels. The Explorer pipeline, the major carrier of oil products to the Mid-West was shut down for 10 days in March and has run at reduced levels since then.

### Signs of Improvement

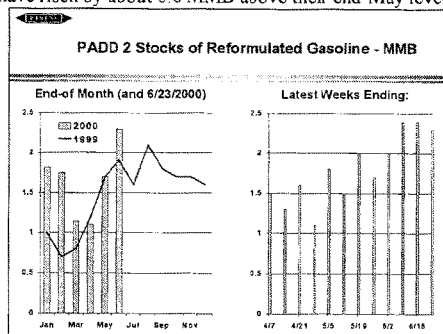
Although data are sparse, there are already some tentative signs of improvement. The disruptions in the logistics system are of course being addressed. However, the sharp run-up in Chicago area prices appears to have encouraged extra-ordinary efforts to bring in supply. This is showing up in a recent rise in stocks of reformulated gasoline in PADD 2, although as noted



## Gasoline 101: A Politically Explosive Topic

earlier, they remain low relative to other parts of the country. The chart below summarizes these trends. While end-of-month stocks in January-February of this year were ahead of 1999 levels, they fell back in March-April to about year-earlier levels. In May as well, they tracked levels of a year ago. As of June 23, inventories have risen by about 0.6 MMB above their end-May level and 0.4 above their level at the end of June 1999. As the weekly data indicate, the build-up was particularly noticeable in the first two weeks of June. This build-up, although modest in overall volume, came despite lower production of reformulated gasoline within PADD 2 itself.

In effect, the modest inventory build in the face of a production decline could only occur if extraordinary efforts were underway to make and ship the product from elsewhere by barge, rail, or even tanker trucks.



The latest Department of Energy statistics indicates the improved local supply situation is filtering through to retail prices. They report that the average price of gasoline in PADD 2 reformulated areas fell from \$2.01/gallon on June 16 to \$1.92 on June 23, a decline of 9 cents a gallon. This was a larger decline than reported for the U.S. as a whole of 2 cents/gallon (from \$1.71 to \$1.69) for all gasoline (and from \$1.73 to \$1.71 for gasoline sold in RFG areas). Retail prices in Chicago and Milwaukee should continue to decline.<sup>10</sup>

### Issues for the Future

While this summer's immediate gasoline problems are easing, they highlight serious regulatory issues that remain with us. None of the individual problems contributing the national, and especially local, gasoline price run-ups were major in and of themselves. However, they came together in the context of a tight global oil market. This condition may persist for some time.

The regulatory system currently in place adds significantly to national, and local vulnerabilities. The multiplication of "boutique" gasolines reduces the flexibility of the distribution system to respond to local supply problems. When they do develop, the regulatory authorities are then faced with a choice of going back on their standards, at least temporarily, or standing by and accepting the inevitable, necessary price spikes.<sup>11</sup> If standards are waived, then those in the industry who made the greatest effort to meet the standards are penalized relative to those who did the least. Creating a "no good deed goes unpunished" precedent sends exactly the wrong

<sup>10</sup> It should be kept in mind that retail prices move more slowly, both up and down, than spot prices. Just as the price increases seen by consumers lagged prices paid by dealers, so too will the price declines as dealers return to more normal margins.

<sup>11</sup> The authorities seem to have chosen a modified version of this alternative, namely stand by and demand investigations.

## Gasoline 101: A Politically Explosive Topic

signal for future compliance efforts. Moreover, there are other regulatory actions that could lead to similar choices. The EPA and many states are moving towards a three-year phase-out of MTBE (penalizing those who invested to produce it in the first place). Because of current oxygenate requirements for reformulated gasoline, this phase-out will mean greatly expanded use of ethanol in producing the Phase II product. Given the problems encountered with ethanol this year, it would be rash to assume a smooth path in the future.

The requirement for the use of an oxygenate is itself questionable since vehicles with fuel injection instead of carburetors (fuel injectors have been in use since 1983) don't need it. California, the country's leader in fuel stringency, has asked that the oxygenate requirement be waived.

There is no argument about the need to improve local air quality and that vehicle emissions will continue to be a legitimate, prime target of regulatory concern. But recent price developments are an urgent signal of the need to reassess the process in view of the supply risks associated with the present system, especially if tight global market conditions persist.

## EXHIBIT XX

"Energy Overview: Are Oil Companies Gouging Consumers?" by Fadel Gheit, Fahnestock & Company, June 21, 2000.

This report notes that the U. S. petroleum refining and marketing industry has averaged less than a 7% return on capital over the last 10 years, and typically earns more than its cost of capital in only one quarter a year. The average profit is \$0.05/gallon in the past five years.

01:13pm EDT 21-Jun-00 Fahnestock & Company (Fadel Gheit 212-668-8935) BPA CHV R  
Energy Overview: Are Oil Companies Gouging Consumers?

\*\* FAHNESTOCK \*\* FAHNESTOCK \*\* FAHNESTOCK \*\* FAHNESTOCK \*\* FAHNESTOCK \*\*

ENERGY OVERVIEW  
June 21, 2000

Fadel Gheit (212) 668-8935 fgheit@fahnestock.com  
John Cusick (212) 668-8028  
Michael McAllister

(212) 668-8228

#### Are Oil Companies Gouging Consumers?

##### No Summer Gifts

Crude oil prices continue to surge despite promises by OPEC to increase production. We don't think that crude oil prices are likely to drop significantly from current levels in the next few weeks even if OPEC, yielding to US pressure, increases production by 200,000 bpd, which is less than 1.0% of world consumption. We believe US strong-arm tactics to pressure OPEC to increase production essentially, has backfired. It is also difficult for US allies in OPEC to justify to their counterparts the logic of subsidizing the world's strongest economies at their own expense. In addition, there is no evidence that \$30/b oil has hurt economic growth or dampened demand growth for petroleum products. Consequentially, US consumers should not keep high hopes for any gifts from OPEC this summer.

##### The Great Gas Conspiracy

The US government is probing possible anti-competitive practices by the oil industry that led to the recent sharp rise in gasoline prices in the Midwest region. The EPA, FTC, Department of Energy, and now Congress are all blaming the oil industry for higher crude oil prices, and, more importantly, higher gasoline prices. Some politicians even suggested investigating the oil industry for possible conspiracy with OPEC. Great minds think alike. High gasoline prices are likely to take center stage in this year's issue-less elections. The Republicans will blame higher gasoline prices in part on "Gore Tax", which is slightly more than four cents/gallon.

##### Are Gasoline Prices High?

Although US motorists complain about high gasoline prices, here are some sobering facts:

1. US gasoline prices adjusted for inflation are now lower than in 1990 or in 1980.
2. Gasoline bills as a percent of disposable income are the lowest in 20 years.

3. Gasoline costs as a percent of total costs of owning an automobile, which include the purchase price and insurance and maintenance, are the lowest in decades and continue to decline as other costs continue to climb.
4. Average gasoline prices in the US are less than half the average prices in Europe and Japan and well below the average prices in many developing countries.
5. Federal, local and other taxes add approximately \$0.40/gallon to the average price of gasoline.
6. US gasoline consumption of more than 370 million gallon/day is at an all time high and is up by 2.4% from last year's levels.
7. The US consumes more than 37% of world gasoline production.

#### Don't Blame The Oil Industry

The petroleum refining and marketing industry is among the worst performing industries when it comes to profitability. Its return on capital in the last 10 years averaged less than 7%, this was by far, the lowest return on capital among the main business segments of the oil industry, lagging exploration and production and chemical. Low margins and high environmental spending made it difficult for the industry to sustain profitable growth for any extended period. We estimate that in the last 10 years the industry returns exceeded its average cost of capital only in one quarter in each year. A very poor record, even for the oil industry.

Americans are led to believe, through the media and self-serving politicians, that they are being milked at the pump by the "Big Oils." Our analysis, however, shows that in the past five years on average oil companies earned less than \$0.05/gallon annually on gasoline sales. The average profit at the peak of the summer driving season is less than \$0.25/gallon, less than \$0.15/gallon in good times and less than \$0.03/gallon in tough times, with most profitable companies averaging \$0.15/gallon.

Nothing herein is to be construed as a solicitation or any transaction. The information presented has been obtained from sources considered to be reliable, but it is not purported to be complete or without error. Fahnestock & Co. Inc., and/or its officers and directors, and/or members of their families may, at times, have positions in any securities mentioned. First Call Corporation, a Thomson Financial company. All rights reserved. 888.558.2500

-> End of Note <-

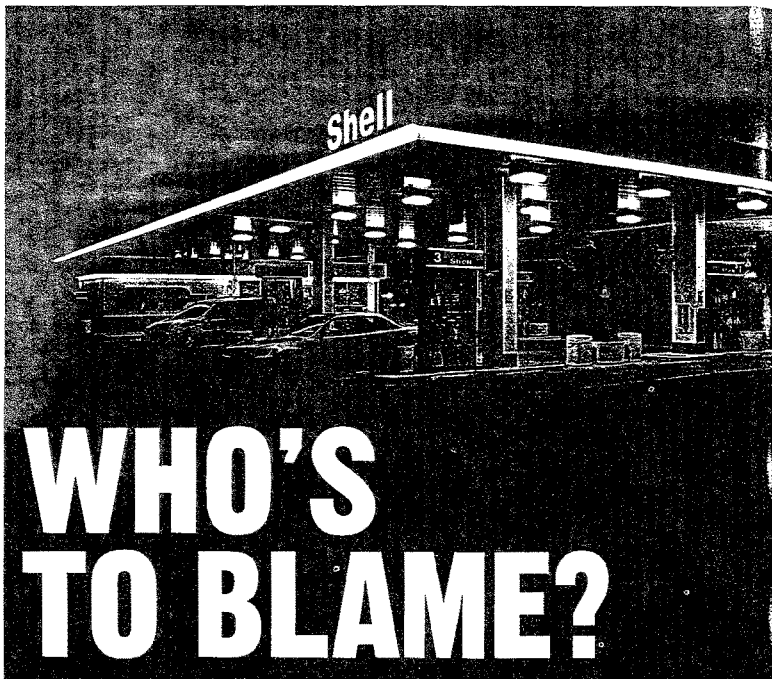
-- FIRST CALL --

## EXHIBIT XXI

"Who's to Blame?", Business Week, July 3, 2000.

This article examines the many accusations being made about the causes of higher gasoline prices; oil companies, OPEC, EPA, oil price speculators, refiners, and Unocal's patent all get their share.

News: Analysis & Commentary



OPEC? Refiners?  
Speculators?  
Regulators? Yes,  
yes, yes, and yes

**P**resident Clinton has all but accused the oil industry of price fixing. The Federal Trade Commission is investigating gasoline refiners and retailers. Various members of Congress, as usual, are calling for hearings. And frustrated consumers are simply looking for some relief at the pump. There hasn't been this much agitation over gasoline prices since the OPEC oil embargo caused prices to double, to more than \$20 a barrel, in late 1973 and early 1974.

So who's to blame? Democrats and consumer groups suspect the oil companies. Republicans and the industry are pointing fingers at the Environmental Protection Agency and recently implemented regulations on cleaner fuel. And of course, everybody is blaming OPEC.

Surprisingly, all these various accusations are correct—to a certain extent. Oil refiners failed to accumulate sufficient stocks of gasoline to meet the summer's peak demand. New clean-fuel regs definitely added to the per-gallon cost. And OPEC—with the help of other producers—has constrained the supply of crude, although as worldwide demand has increased since the beginning of the year, OPEC's grip has loosened. It was a fatal confluence of events, none of which by itself would have produced a national average price of \$1.68 per gallon—a record before it is adjusted for inflation.

But one last element in the runup may be the least acknowledged: market psychology and expectations. Analysts say the markets for crude oil and gaso-

PHOTOGRAPH BY TODD BODIN/ANALYST, CHART BY ALBERTO MENENDEZ

JULY 3, 2000



Regular

218

Plus

228 9

Premium

238 9

CHICAGO AND THE MIDWEST  
HAVE BEEN HARDEST HIT

line are no different than those for equities. Prices are set by a combustible blend of speculation, greed, and fear. While supply and demand rules in the long run, the near-term price of unleaded gas has been set as much by bets of thousands of large and small market players. Says Shell Oil Co. Chairman and CEO Steven Miller: "The perception of future oil supply and demand has a lot to do with the current price."

Indeed, a failed bet made by refiners last winter that prices for crude oil and gasoline would be lower this spring has prompted much of the current market hysteria. Last December and January, as the price of crude hovered in the mid- to high 20s, refiners—already struggling to supplement insufficient

heating-oil stocks—failed to build gasoline inventories to the levels necessary to meet the heightened demand of the summer's peak driving season. They thought that higher interest rates would take their toll on the U.S. economy and consumption. Then, as the biggest per capita consumer of oil lost its appetite, the price of crude would fall and they could stock their refineries for less.

Crude-oil futures prices seemed to support this scenario. But speculators also watched gasoline inventories, and they, too, made a bet—that the rush to stock up would drive crude prices higher. Prices never went below \$25, which left refiners scurrying to find affordable supply. "Refiners weren't anticipating \$30 oil this late in the game," says Howard Rennell, president of Windham Group, a New York-based oil broker. "When they came back into the market, they bid the price up further."

Despite the current nationwide panic, the price spike may dissolve as demand falls over the summer and refiners finish supplementing inventories. What is less likely to fade is the market's increasing volatility. The oil industry has adopted the same just-in-time approach as auto makers and retailers. Companies keep smaller stocks of crude oil and refined products. They no longer pay costly leases on fields they aren't ready to explore. And they don't drill production wells in fields when they don't need oil. So when demand leaps, they don't have much extra capacity.

The surprise this spring was the strength of the demand given the Federal Reserve Board's vigorous efforts to slow the economy. The Energy Dept. estimates that world demand will rise 1.8% this year and 2.5% in 2001, vs. 1.4% in 1999. "What all the calculations did not do was foresee the rebound in oil demand," says Daniel H. Yergin,

chairman of Cambridge Energy Research Associates. "Few saw how buoyant the U.S. economy would be. And few expected a strong rebound in Asia so soon."

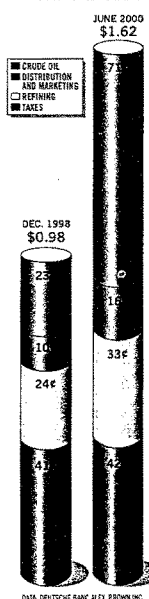
Meantime, refiners have hardly been scrambling to add capacity—for good reason. Until recently, gasoline prices had been totally uninspiring—particularly for a refining industry that returned less than 4% on capital in the decade of the 1990s, according to the American Petroleum Institute, an industry trade organization. That is less than half the average of the energy industry as a whole and well below the returns of the average Standard & Poor's 500-stock index company. On top

of the lousy prices, refiners also had to invest as much as \$90 billion to meet the new environmental requirements. The result: Gasoline production has increased only from 6.4 million barrels per day in 1984 to 8.5 million today. And now, even though gasoline demand has grown significantly, stocks of crude oil and gasoline are kept at around 500,000 barrels—down from the typical 800,000 barrels refiners would hold in the early 1980s.

The flash point for the U.S. crisis has been the Upper Midwest, where prices have topped \$2.10 a gallon for regular unleaded in cities such as Detroit and Milwaukee, and more than \$2.30 in Chicago. The region suffered two major pipeline outages since March and a refinery shutdown that further cut already constrained gasoline supplies—exactly the unexpected disruptions that just-in-time inventories cannot accommodate.

**SHIRKERS.** At the same time that refiners faced insufficient stocks, they also were wrestling with a new phase of reformulated gasolines, which took effect in about one-third of the nation beginning on June 1. But having known about these

## WHY SO HIGH?

AVERAGE PRICE OF  
GASOLINE PER GALLON

DATA: DEUTSCHE BANK ALEX. BROWN INC.

BUSINESS WEEK / JULY 3, 2000 37

## News: Analysis &amp; Commentary

changes for years, why weren't they better prepared? "The industry helped us write [the regs]. They should have had enough time," says EPA Assistant Administrator Robert Perciasepe.

Refiners say implementing all of the new formulas proved more complex than expected. Here, some of the blame lies with the states. The mandate to make cleaner-burning reformulated gasoline originally came from Washington, but individual states have tinkered with the formulations to suit their own particular air-quality problems and political interests. Atlanta and Birmingham, Ala., for instance, have different gasoline standards than Jacksonville and Tampa, Fla. El Paso is required to sell a different formula than East Texas. Citgo Petroleum Corp., a major U.S. refiner, says it must provide nine different forms of gasoline in just the eastern half of the country to satisfy the various permutations.

The reformulated gasoline already costs more to produce. But refinery officials say it is no coincidence that the Midwest suffered the highest prices in an effort to try to meet the EPA standards. Many of those states, in a nod to their farm constituencies, encourage the use of corn-based ethanol as an additive. In many other areas of the country, refiners use a natural gas-based additive called MTBE. Ethanol creates problems, refiners say, because it is difficult to store and causes gasoline to evaporate more quickly. In addition, because of the difficulty of making this gasoline, refineries produce less of it than conventional blends, leading to supply shortages.

Environmental regulators and industry officials had anticipated that the new fuels would cost more: 5¢ to 8¢ per gallon was the original estimate. But that didn't include the market's reaction to a supply shortage. Indeed, in the Midwest, reformulated currently



NEW YORK MERC: LOW INVENTORIES INVITED SPECULATION IN CRUDE-OIL FUTURES

sells for an average of 16¢ more than conventional gasoline.

Further complicating matters was a suit won recently by Unocal Corp. supporting the company's claims that it held the patent on certain types of reformulated gasoline and was owed royalties from other refiners. As a result, refiners did everything they could to avoid using Unocal formulas, leading to additional costs and further shortages.

The trouble in the Midwest should have come as no surprise to gasoline

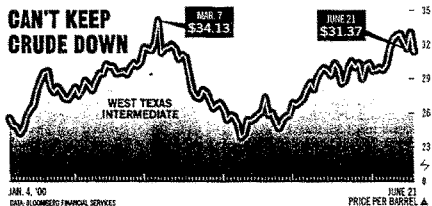
consumers in California. After the state mandated its own special reformulated gasoline blend in March, 1996, the price of gasoline took off, jumping 30%, to \$1.60 a gallon. Consumers were outraged. There were at least four separate state and federal investigations of California's gas prices, but no charges of improprieties were ever filed against the state's refiners. Capacity in the state is so tight that whenever there is a refinery outage, gasoline marketers must find out-of-state refiners who can meet California requirements.

**PROFITS GALORE.** But for the industry—though certainly not the consumer—there's a silver lining to all this. Thanks to higher oil prices and refining margins, analysts expect the average large oil company to double its earnings this year.

In the second quarter, U.S. refining profits per barrel doubled from the levels of a year ago, to an average of \$6.50 per barrel, one of the highest quarterly averages in a decade.

Of course, at these prices, oil companies and refineries are beginning to figure out ways to create more supply. Already, there is evidence that exploration and production spending is picking up. According to Lehman Brothers' mid-year E&P spending survey, as of May, companies are planning an 18.2% increase in worldwide E&P expenditures in 2000, vs. a 10.2% rise budgeted in December, 1999, when E&P budgets were originally put together. That 18.2% represents some \$36.7 billion in spending, vs. \$73.4 billion in 1999. And as of June 16, the U.S. rig count, at 871 actively drilling, had increased to its highest level since mid-May, 1998. That may be good news for the consumer. But in the meantime, better buy a compact to keep that sport-utility vehicle company.

By Christopher Palmeri in Los Angeles and Stephanie Anderson Forest in Dallas, with Roger O. Crockett in Chicago and Lorraine Woellert in Washington



## COMMENTARY

By Stanley Reed

## DON'T BLAME SURGING PUMP PRICES ON OPEC

**T**he Organization of Petroleum Exporting Countries has a message for the U.S.: There is a limit to how much we can do to lower current crude oil prices and, by extension, U.S. gasoline prices.

Of course, the 11 cartel members are being far too modest. It was, after all, their production cutbacks that started the upward price spiral in 1999 in the first place. But some facts do support the idea that their influence over prices may indeed be declining.

For starters, not only did OPEC promise to produce an additional 1.7 million barrels per day in March, it is actually surpassing that pledge by 600,000 barrels. So, throughout the second quarter, the Paris-based International Energy Agency reckons that daily worldwide production has been exceeding worldwide consumption by as much as 1.9 million barrels. Yet crude oil prices are trading close to their March peak.

**ALL THE WAY.** Nevertheless, led by Saudi Arabia, the world's largest exporter, OPEC pledged on June 21 to hike production again, this time by around 700,000 barrels. Mexico, which is not a member of OPEC, is also expected to add 150,000 to 200,000 barrels a day, bringing its production back to the levels hit before oil producers began their regime of cutbacks more than a year ago.

Will these hikes make a difference? Ali I. Naimi, the Saudi Minister of Petroleum & Mineral Resources, isn't sure—primarily because he doubts that it was a shortage of crude oil that caused June's spikes in gasoline prices and crude. "Producers are trying to match supply and demand to establish stability in the market," he said in an interview in Riyadh, Saudi Arabia, just before leaving for OPEC's meeting in Vienna. "We are under tremendous pressure to increase production to respond to an apparent shortage of supply. But other than prices going up, the data doesn't support" the notion that there's a shortage.



Naimi: Speculators are part of the problem

Naimi blames speculators for at least some of the price spikes. They saw very low gasoline and heating-oil inventories in the U.S. and a demand that didn't seem to be declining despite interest-rate hikes. Traders began betting that refiners would have to come into the market late to add to their inventories.

"They are putting enormous pressure on the upper end to see if we are going to ease," says Naimi. Of course, Naimi is hardly a disinterested observer. But David H. Knapp, who heads the IEA's oil-industry and markets division, agrees. He says incredibly tight product invento-

ries in the U.S. are the main catalyst for higher crude prices. "It isn't so important what OPEC does as what the refiners do," says Knapp.

"This is very much a product-led global oil market."

Moreover, the Saudis are also uncomfortable with prices as high as they are. With 1.9 million to 2.4 million barrels of spare capacity, the Saudis probably would have been willing to push production above 700,000 barrels just to avoid more heat from U.S. and Asian customers.

**WINTER CHILL.** But by ramming through a production hike, the Saudis would have risked the wrath of other OPEC members, such as Iran and Algeria, that don't have excess capacity. For them, a drop in price just means

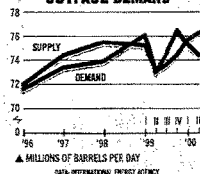
lower revenues and the potential loss of market share to new production. Besides Saudi Arabia, only the United Arab Emirates has a noteworthy 500,000 barrels a day of spare capacity to offer. And there is not much among non-OPEC producers either—although the IEA reports that Mexico is working hard to develop new supply.

That lack of slack leaves the market vulnerable. Principally, analysts are doubtful that Iraq can sustain a production of 9 million barrels a day.

So, the balancing act is getting very difficult for all of the players. Even if prices drop as the summer progresses and demand for gasoline begins to ease up in the U.S., analysts expect a similar crisis next winter, given the low levels of heating-oil inventories. So if OPEC doesn't increase now, it will face another crisis come its Sept. 10 meeting.

Reed covers the oil industry for *BUSINESS WEEK* from London and the Mideast.

## CRUDE SUPPLIES AGAIN OUTPACE DEMAND



DATA: INTERNATIONAL ENERGY AGENCY

## BusinessWeek ONLINE

For an interview with Ali I. Naimi, go to the June 21 daily briefing at [www.businessweek.com/today.htm](http://www.businessweek.com/today.htm)



EXHIBIT XXII

J. L. Frank Testimony on Diesel Sulfur, EPA Public Hearing, June 19, 2000, New York

This is a speech delivered at an EPA public hearing in New York on June 19, 2000 by J. L. Frank, President of Marathon Ashland Petroleum LLC.

*EPA Public Hearing, New York, June 19, 2000*

Good morning. I'm J. Louis Frank, president of Marathon Ashland Petroleum LLC. I'm here today on behalf of the American Petroleum Institute.

The energy industry asks that you carefully consider our views on EPA's recently proposed diesel sulfur regulations.

First, understand that we support reducing sulfur content. This is an area where fuel producers can make a positive contribution. U.S. air quality has benefited because *of* -- and in proportion *to* -- the extent we have formulated fuels to cut tailpipe and exhaust stack emissions.

EPA statistics *prove* that nearly two-thirds of America's air quality improvement is due to clean fuels and clean engine technology. Moreover, the improvement has been steady and is ongoing. I'm proud of that result.

Please note that there was no magic involved, no instant alchemy. It was a painstaking process of finding what worked -- technically, economically, commercially. We do this for a living. We can't afford to be wrong. Costs and benefits have to balance.

And that goes to the heart of industry's contention that pushing beyond a 90 percent reduction in diesel sulfur puts wishful thinking ahead of market reality. EPA's case is based on the use of vehicle technology that is still unproven. This is technology which EPA admits has not advanced from the chalkboard to the field trial stage. In preliminary tests, the EPA recommended technology has failed to hit target emission levels --regardless of fuel sulfur content.

Industry knows how to hit the 15 ppm standard. But we also know that volumes are cost-constrained. Many refiners will choose to produce less product. Any trucker or fleet operator can tell you what that will do to their business. Our estimate is that EPA's proposal would add about \$2,500 to the cost of a trucker's annual operation.

Real-world constraints will also affect our ability to maintain the 15 ppm standard through thousands of miles of pipeline shipment, terminal storage and station disposition. Fifteen parts per million is equivalent to less than a tablespoon of water in an Olympic-size swimming pool. Contamination at the molecular level could endanger this fragile standard. The reality is that refiners would actually have to reduce levels below 15 ppm to have a reasonable assurance that product stayed on spec.

EPA has raised the possibility of phasing in its sulfur requirements to mitigate their impact. This would necessitate purchasing additional tanks, piping and pumps to accommodate the sale of two varieties of highway diesel. Bottom line: less efficiency, more costs.

I am saying to you – on behalf of America's energy industry – that we are prepared to undertake a 90 percent reduction in diesel sulfur level – knowing full well what that entails in terms of production cost, quality maintenance, and capital investment.

We support this reduction and we understand its potential health benefit.

This is not a poker game. We are not arguing over table stakes. Anyone can demand too much too soon. Setting an appropriate regulatory standard, however, demands wisdom, courage and care.

Thank you for your time and consideration.

## EXHIBIT XXIII

## J. L. Frank letter to EPA on Diesel Sulfur, June 23, 2000

Letter to Office of Transportation and Air Quality, Environmental Protection Agency from J. L. Frank, President of Marathon Ashland Petroleum LLC, June 23, 2000. The letter expresses concern over EPA's arbitrary approach to the determination of costs and benefits of the API proposed 50 PPM sulfur limit on diesel fuel.

June 23, 2000

Fax No: 202-564-1686  
Ms. Margo T. Oge  
Director  
Office of Transportation and Air Quality  
Environmental Protection Agency  
1200 Pennsylvania Ave., NW  
Washington, DC 20004

Dear Margo:

This letter is in response to your question at the New York Heavy Duty Highway Diesel NPRM hearing on June 19, 2000 regarding the calculation of benefits from the 50 ppm cap/30 ppm average sulfur that the oil industry has proposed for highway diesel fuel.

At that time I was unfamiliar with the methodology upon which EPA has based its conclusion that the industry's proposal would only achieve 20% of EPA's proposed benefits. I have now reviewed Chapter IX.C. of the agency's Regulatory Impact Analysis (RIA) and I am still at a loss to determine the basis EPA used to determine the benefits of 50 ppm sulfur.

The RIA totally ignores the real world experience of thousands of vehicles in Europe, which are already demonstrating the ability to meet Euro 5 standards on 50 ppm sulfur diesel fuel. This appearance of the agency's deliberate under valuation of the oil industry's proposal casts doubt on EPA's willingness to undertake a science-based, unbiased analysis of alternatives to this proposed rule.

I am very concerned with the apparent arbitrariness of EPA's approach, and would like to present the oil industry's case. There are many categories of potential benefits listed in the RIA. However, the primary benefits are in the areas of PM and NOx emission reductions and those are the two areas I will address.

The industry's proposed 50 ppm/30 ppm average sulfur level enables virtually the same PM benefits as EPA's proposal of a 15 ppm sulfur cap. Over 8,000 European diesel vehicles, both light and heavy duty, are currently operating catalyzed diesel particulate filters (CDPF's) satisfactorily on 50 ppm sulfur fuel. Both Johnson-Matthey and Engelhard have publicly released data showing that PM emissions below EPA's proposed FTP PM standard of 0.01 gm/bhp-hr can be achieved using 50 ppm sulfur diesel fuel.

Ms. Margo Oge  
 June 23, 2000  
 Page 2

I am aware that EPA is concerned that out of these thousands of successful applications, there are fourteen failures on retrofitted buses in Finland. MECA and EMA have characterized these failures as being due to the inability to maintain the required temperature levels to assure regeneration. I am confident that EMA and MECA, given seven years lead time, can determine the appropriate level of insulating material or other engine calibration techniques to maintain the 20° C higher temperatures required to enable CDPF's to perform properly on 50 ppm cap/30 ppm average sulfur diesel. This task is made much simpler since they will be customizing the CDPF's for each new engine family.

In addition, I am aware that EPA is concerned about sulfate make and PM compliance over the proposed Supplemental Steady-State (SS) and Not-to-Exceed (NTE) test procedures. The DEC-SE study shows that on 30 ppm fuel current traps can meet PM levels of 0.02 g/bhp-hr over the OICA cycle – an 80% reduction from today's levels. The apparent arbitrary nature in which EPA selected the SS and NTE standards is troubling since it forces compliance far below the stated emission standards. EPA is claiming no environmental benefits associated with these standards beyond ensuring adequate in-use control. EPA could achieve the same in-use control through design and implementation of an effective EPA compliance and enforcement program without jeopardizing our nations fuel supply.

On NOx control, I am surprised that EPA would completely dismiss SCR technology, which is the NOx reduction technology of choice in Europe and like the CDPF has been tested and proven on thousands of European diesel vehicles using 50 ppm and higher sulfur diesel fuel. This technology easily achieves NOx levels of 0.5 gm/bhp-hr, and EPA even points out in the RIA that this technology may be capable of meeting the proposed 0.02 g/bhp-hr standard by 2007. SCR technology is ready to go today and does not need a four year phase-in or a technology review. In fact, it's ability to be operating in 100% of 2007 new diesel vehicles allows SCR technology to generate more early NOx emission reduction benefits than EPA's proposal.

While Heavy Duty Engine SCR is relatively insensitive to diesel sulfur levels, the Compact SCR technology to be used in smaller vehicles is reportedly somewhat sulfur sensitive, since it incorporates a platinum based oxidation catalyst. However, these catalysts are very similar to current gasoline oxidation catalysts, which successfully operate at sulfur levels up to 80 ppm. With the very low sulfur levels of 50 ppm, this technology is capable of meeting the 0.5 gm/brkhp-hr standard for the life of the vehicle.

It is difficult to understand why EPA would ignore a proven, ready-to-go technology, such as SCR, in favor of a totally unproven technology, such as NOx Adsorbers. In the NPRM EPA repeatedly refers to the relative risks of each technology. EPA needs to truly quantify these risks and calculate the risk corrected expected benefits of each technology path. This will demonstrate that the NOx Adsorber technology, even if given a very optimistic risk factor of 50%, plus its 15 ppm diesel

requirement, is too risky and has a much lower expected benefit value than the oil industry's recommendation.

Sincerely,

(Original Signed by J. L. Frank)

/ab

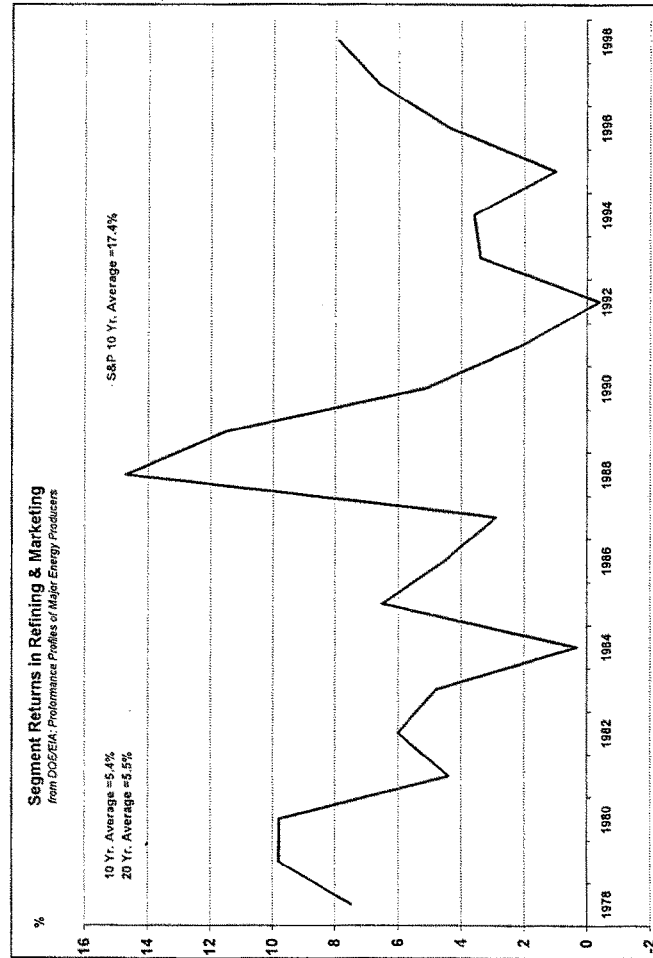
Attachment

cc:	The Honorable Carol M. Browner Administrator Environmental Protection Agency 1200 Pennsylvania Ave., NW Washington, DC 20460	Fax No: 202-501-1450
	The Honorable Bill Richardson Secretary of Energy U.S. Department of Energy 1000 Independence Ave., SW Washington, DC 20585	Fax No: 202-586-7644
	Mr. Robert Perciasepe Assistant Administrator Office of Air and Radiation Environmental Protection Agency	Fax No: 202-564-1686
	Ms. Melanie Kenderdine Acting Director Office of Policy Department of Energy	Fax No: 202-586-0148
	Mr. John Spotila Office of Management and Budget Eisenhower Executive Office Building 17 <sup>th</sup> and Pennsylvania Ave, NW Washington, DC 20503	Fax No: 202-395-4852
	Ms. Patricia M. Richards USX Corporation Washington, DC	Fax No: 202-783-6309
bcc:	Red Cavaney, American Petroleum Institute Edward H. Murphy, American Petroleum Institute Urvan Sternfels, NPRA MAP Board of Managers and Officers w/attachment M. E. Leister w/attachment	

## EXHIBIT XXIV

**Segment Returns in Refining and Marketing (Source: DOE/EIA: Performance Profiles of Major Energy Producers)**

This chart depicts the return on capital of the refining and marketing segments of U. S. Petroleum industry. The data was drawn from the DOE/EIA: Performance Profiles of Major Energy Producers.



## EXHIBIT XXV

**A Primer on Gasoline Prices (EIA pamphlet, [www.eia.doc.gov](http://www.eia.doc.gov))**

This brochure published by DOE/EIA explains the various components of the retail price of gasoline and why prices change from time to time and differ according to regions.

**A Primer on Gasoline Prices**

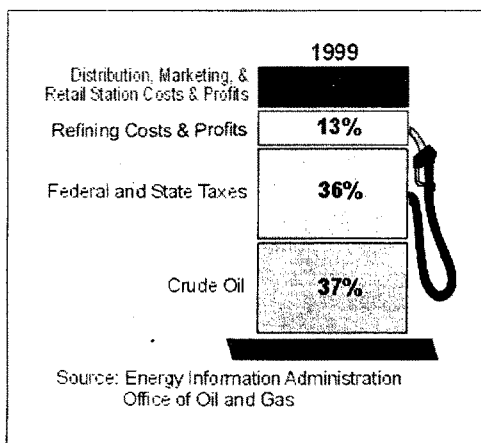
**G**asoline, one of the main products refined from crude oil, accounts for just about 20 percent of the energy consumed in the United States. The primary use for gasoline is in automobiles and light trucks. Gasoline also fuels boats, recreational vehicles, and various farm and other equipment. While gasoline is produced year-round, extra volumes are made in time for the summer driving season. Gasoline is delivered from oil refineries mainly through pipelines to a massive distribution chain serving 180,000 retail gasoline stations throughout the United States. There are three main grades of gasoline: regular, midgrade, and premium. Each grade has a different octane level. Price levels vary by grade, but the price differential between grades is generally constant.

**What are the components of the retail price of gasoline?**

The cost to produce and deliver gasoline to consumers includes the cost of crude oil to refiners, refinery processing costs, marketing and distribution costs, and, finally, the retail station costs and taxes. The prices paid by consumers at the pump reflect these costs, as well as the profits (and sometimes losses) of refiners, marketers, distributors, and retail station owners.

In 1999, when the price of crude oil averaged \$17.46 per barrel, crude oil accounted for about 37% of the cost of a gallon of regular grade gasoline (Figure 1). The share of the retail price of regular grade gasoline that crude oil costs represent varies somewhat over time and among regions. For example, on the West Coast, crude oil represented about 31% of the price of gasoline in 1999, while on the Gulf Coast, it represented 39%.

Figure 1. What Do We Pay for in a Gallon of Regular Grade Gasoline?



**Federal, State, and local taxes are a large component of the retail price of gasoline.** Taxes (not including county and local taxes) account for approximately 36 percent of the cost of a gallon of gasoline. Within this national average, Federal excise taxes are 18.4 cents per gallon and State excise taxes average 19.96 cents per gallon. Also, seven States levy additional State sales taxes, some of which are applied to the Federal and State excise taxes.<sup>1</sup> Additional local county and city taxes can have a significant impact on the price of gasoline.

**Distribution, marketing and retail station costs and profits combined make up 14% of the cost of a gallon of gasoline.** Only 28% of service station outlets today are company stations, i.e., are owned or leased by a major oil company and operated by its employees. Nearly 72% are operated by independent dealers free to set their own prices. The price on the pump reflects both the retailer's purchase cost for the product and the other costs of operating the service station. It also reflects local market conditions and factors, such as the desirability of the location and the marketing strategy of the owner.

---

<sup>1</sup>U. S. Department of Transportation, Federal Highway Administration, *Monthly Motor Fuel Reported by States*, February 2000, Table MF-121T.

#### **Why are California gasoline prices higher and more variable than others?**

The State of California implements its own reformulated gasoline program with more stringent requirements than Federally-mandated clean gasolines. In addition to the higher cost of cleaner fuel, there is a combined State and local sales and use tax of 7.25 percent on top of an 18.4 cent-per-gallon federal excise tax and an 18.0 cent-per-gallon State excise tax.

California prices are more variable than others because there are relatively few supply sources of its unique blend of gasoline outside the State. California refineries need to be running near their fullest capabilities in order to meet the State's fuel demands. If more than one of its refineries experiences operating difficulties at the same time, California's gasoline supply becomes very tight and the prices soar. Supplies could be obtained from the Gulf Coast and foreign refineries; however, California's substantial distance from those refineries is such that any unusual increase in demand or reduction in supply results in a large price response in the market before relief supplies can be delivered. The farther away the necessary relief supplies are, the higher and longer the price spike will be.

#### **Why Do Gasoline Prices Fluctuate?**

Even when crude oil prices are stable, gasoline prices normally fluctuate due to factors such as seasonality and local retail station competition. Additionally, gasoline prices can change rapidly due to crude oil supply disruptions stemming from world events or domestic problems, such as refinery or pipeline outages.

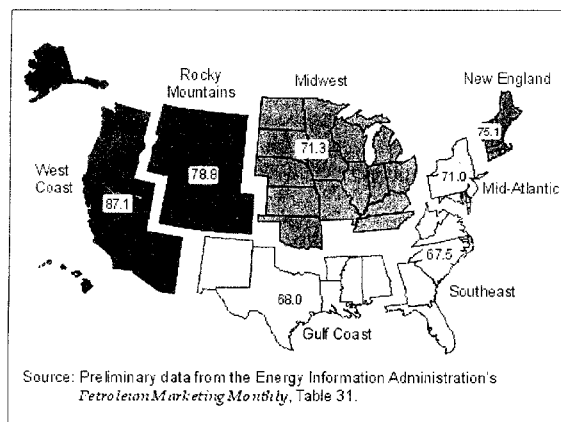
**Seasonality in the demand for gasoline** - When crude oil prices are stable, retail gasoline prices tend to gradually rise before and during the summer, when people drive more, and fall in the winter. Good weather and vacations cause U.S. summer gasoline demand to average about 5% higher than during the rest of the year. Prices during the summer typically show a 3.5 cent-



per-gallon increase, even after correcting for changes in crude oil prices.

*Changes in the cost of crude oil* - Events in crude oil markets were a major factor in all but one of the five run-ups in gasoline prices between 1992 and 1997, according to the National Petroleum Council's study *U.S. Petroleum Supply - Inventory Dynamics*.

Figure 2. Motor Gasoline Prices at Retail Outlets, 1999 Average Regular Grade, by Region (cents per gallon, **excluding taxes**)



Crude oil prices are determined by worldwide supply and demand, with significant influence by the Organization of Petroleum Exporting Countries (OPEC). Since it was organized in 1960, OPEC has tried to keep world oil prices at its target level by setting an upper production limit on its members. OPEC has the potential to influence oil prices worldwide because its members possess such a great portion of the world's oil supply, accounting for nearly 40% of the world's production of crude oil and holding about 67% of the world's estimated crude oil reserves.

Rapid gasoline price increases have occurred in response to crude oil shortages caused by, for example, the Arab oil embargo in 1973, the Iranian revolution in 1978, the Iran/Iraq war in 1980, and the Persian Gulf conflict in 1990. The most recent gasoline price increases are due in part to OPEC crude oil production cuts in 1999. In addition, higher demand from a recovering Asian economy caused more competitive bidding for crude oil supplies in the international market and was a contributing factor to an increase in gasoline prices in 1999.

*Product supply/demand imbalances* - A continuing economic boom in the United States has led to greater demand for gasoline. If demand rises quickly or supply declines unexpectedly due to refinery production problems or lagging imports, gasoline inventories (stocks) may decline rapidly. When stocks are low and falling, some wholesalers become concerned that supplies may not be adequate over the short term and bid higher for available product. Such was the case

in late summer 1997, as a demand surge drained gasoline stocks and prices rose rapidly.

Gasoline may be less expensive in one summer when supplies are plentiful vs. another summer when they are not. These are normal price fluctuations, experienced in all commodity markets. For example, the price of corn is higher than normal just before harvest time because corn inventories are depleted at that time. Prices may remain high after the harvest if a drought occurred during the growing season, thereby limiting the supply of corn. Or prices may decline when a healthy crop is produced.

However, prices of basic energy (gasoline, electricity, natural gas, heating oil) are generally more volatile than prices of other commodities. One reason is that consumers are limited in their ability to substitute between fuels when the price for gasoline, for example, fluctuates. So, while consumers can substitute readily between food products when relative prices shift, most do not have that option in fueling their cars.

### **Why do gasoline prices differ according to region?**

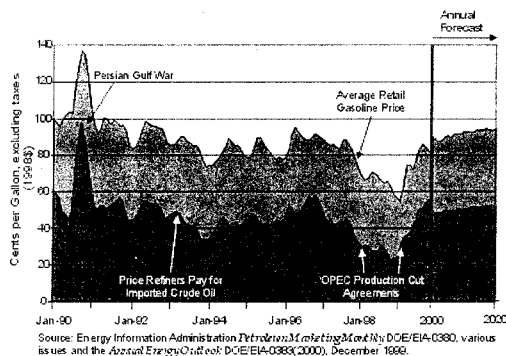
Although price levels vary over time, Energy Information Administration (EIA) data indicate that average retail gasoline prices tend to be typically higher in certain States or regions than in others (Figure 2). Aside from taxes, there are other factors that contribute to regional and even local differences in gasoline prices:

*Proximity of supply* - Areas farthest from the Gulf Coast (the source of nearly half of the gasoline produced in the U.S. and, thus, a major supplier to the rest of the country) tend to have higher prices. The proximity of refineries to crude oil supplies can even be a factor, as well as shipping costs (pipeline or waterborne) from refinery to market.

*Supply disruptions* - Any event which slows or stops production of gasoline for a short time, such as planned or unplanned refinery maintenance, can prompt bidding for available supplies. If the transportation system cannot support the flow of surplus supplies from one region to another, prices will remain comparatively high.

*Competition in the local market* - Competitive differences can be substantial between a locality with only one or a few gasoline suppliers versus one with a large number of competitors in close proximity. Consumers in remote locations may face a trade-off between higher local prices and the inconvenience of driving some distance to a lower-priced alternative.

**Figure 3. The Price Refiners Pay for Imported Crude Oil and Average Retail Gasoline Price (Average of All Grades)**



#### Long-term (Years 2000 to 2020) Outlook for Gasoline Prices

In the future, gasoline prices are expected to be pushed generally higher by an increase in the population and an economic expansion, particularly in the third world (Figure 3). In addition, tighter environmental standards on the quality of gasoline will also be a factor in higher prices as will the lack of available U.S. refining capacity. The lack of available refining capacity is already contributing to higher retail prices in California (see box on California) and is expected to spread to other States. Offset by lower tax rates, though, U.S. retail gasoline prices are expected to remain among the lowest in the world.

**Environmental programs** - Some areas of the country are required to use special gasolines.

Environmental programs, aimed at reducing carbon monoxide, smog, and air toxics, include the Federal and/or State-required oxygenated, reformulated, and low-volatility (evaporating more slowly) gasolines. Other environmental programs put restrictions on transportation and storage. The reformulated gasolines required in some urban areas and in California add three and five cents, respectively, to the price of conventional gasoline served elsewhere.

**Operating costs** - Even stations co-located have different traffic patterns, rents, and sources of supply that influence retail price.

Additional copies of this pamphlet may be obtained from EIA by contacting the National Energy Information Center (NEIC) at 202-586-8800 or E-Mail: [infoctr@eia.doe.gov](mailto:infoctr@eia.doe.gov). The full text is available on EIA's Web site [www.eia.doe.gov](http://www.eia.doe.gov) under "Petroleum," then select "Analysis" on the left sidebar.

The Energy Information Administration publishes many analytical reports on the subject of motor gasoline price changes. For more technical analyses, see: *Price Changes in the Gasoline Market*, *Motor Gasoline Assessment Spring 1997*, and *Assessment of Summer 1997 Motor Gasoline Price Increases*. These analyses, and others, are available at [www.eia.doe.gov](http://www.eia.doe.gov) under "Petroleum," then select "Analysis" on the left sidebar.

EXHIBIT XXVI

**CATO Institute Testimony, House Committee on Government Reform, "The Effect of Federal Regulations on Gasoline Prices in Milwaukee/Chicago Area", July 7, 2000.**

The CATO Institute testimony before the House Committee on Government Reform examines the factors contributing to the gasoline supply shortfall and the economic forces, which caused the elevated prices.

**TESTIMONY of**

Jerry Taylor,  
Director, Natural Resource Studies, Cato Institute

before the

Committee on Government Reform  
Subcommittee on National Economic Growth,  
Natural Resources, and Regulatory Affairs  
United States House of Representatives

**The Effect of Federal Regulations on Gasoline Prices in the Milwaukee/Chicago Area**

July 7, 2000

---

I'd like to thank the members of the Subcommittee on National Economic Growth, Natural Resources, and Regulatory Affairs for the opportunity to testify today on the effect that federal regulations have had on gasoline prices in the Milwaukee/Chicago area.

There is no mystery as to why gasoline prices have spiked here but nowhere else: the Milwaukee/Chicago market is suffering from a shortage of gasoline and this shortage is entirely responsible for the surge in prices. My testimony today will examine the factors that have contributed to this shortfall as well as the economic laws that govern gasoline markets. In short, the June spike in Milwaukee/Chicago gasoline prices was largely caused by federal and state regulations mandating the use of ethanol blended reformulated gasoline in this market.

The only other explanation for the price spike that's been offered - the contention that oil companies are colluding to gouge consumers - is also examined and dismissed as extremely unlikely. No single oil company has enough market power to significantly affect retail prices and there is absolutely no evidence of collusion. A basic understanding of the gasoline markets strongly suggests that, if prices had not gone up dramatically in May/June, 1970-style gasoline lines at the pump would have been the inevitable result.

I conclude by suggesting some policy steps that would reduce the likelihood of such disruptions in the future. Less - not more - regulation is in order.

### **The National Gasoline Market**

A gallon of gasoline in the United States today is - on average - 60 cents more expensive than it was a year ago. This represents about a 50 percent increase in price. Gasoline prices in the Milwaukee/Chicago area, however, peaked at about double the price of a year ago.

So about half the price increase experienced in the Milwaukee/Chicago area was due to the general increase in world oil prices. The Congressional Research Service, for instance, reports that refiners' crude acquisition costs have risen by the equivalent of 48 cents per gallon of gasoline over the past year and a half. That price increase is explained by three factors; OPEC production restraint, low domestic inventories of oil, and surging demand for oil products. About this there is little dispute, so I will not dwell upon it this morning.

As an aside, the price increase appears more dramatic than it actually is. First, it was preceded by the lowest inflation-adjusted oil prices in recent history: less than \$10 a barrel in December 1998, a price that allowed gasoline to sell at \$1.05 a gallon. Price increases were virtually inevitable, and given the historic lows of December 1998, they were bound to appear dramatic by comparison. Second, real prices even in the Milwaukee/Chicago area still don't approach the historic peak price of \$2.67 a gallon, which was set nationally in March 1981 after adjusting for inflation.

Nevertheless, why are prices higher in the Milwaukee/Chicago area than elsewhere? Simply put, the imbalance between gasoline supply and demand is greater here than elsewhere in the country.

### **Imbalances in Supply & Demand**

Disruptions in the transportation network are primarily responsible for limiting the supply of gasoline in the Milwaukee/Chicago area. An inability on the part of refiners to produce enough gasoline to keep up with surging demand has also contributed to the problem. Given the inelasticities of the gasoline market, those two factors alone explain the disparity between regional and national prices.

Gasoline demand has increased by 4 percent since last year according to the American Automobile Association but supply has remained unchanged. This imbalance is complicated by a shrinkage in inventory stocks: mid-June national inventories of reformulated gasoline were 6 percent below the June 1999 level and 16 percent below those of June 1998.

While this disparity between the supply and demand of reformulated gasoline has affected all markets that rely on the reformulated gasoline equally, the Milwaukee/Chicago market has been additionally hit by a production shortfall of the specific blend of reformulated gasoline that is required there and nowhere else. Going into the spring, only six refineries (all located in Illinois) were producing RBOB that could be sold in the Milwaukee/Chicago market. But production at those and the other facilities making gasoline dedicated to the Milwaukee/Chicago market is running about 7 percent below production a year ago and stockpiles are unusually low.

The cheapest and easiest way to supplement the production at those Illinois facilities is to ship gasoline via pipelines from Gulf Coast refineries. Unfortunately, the main pipeline that services the Milwaukee/Chicago area - the Explorer pipeline, which ships gasoline from refineries on the Gulf Coast to Chicago - experienced a major fire near St. Louis in March. Although the damage was repaired quickly and the pipeline opened for business ten days later, the owners of the pipeline and the U.S. Department of Transportation entered into a joint agreement to reduce the operating pressure of the pipeline by 20 percent, which reduced the volume of gasoline moving through the pipeline by 10 percent. A rupture in the Wolverine Pipeline on June 8 - the one dedicated reformulated gasoline pipeline from Chicago to Detroit that serves the Milwaukee region -- has further reduced pipeline traffic by 20 percent although it returned to full operation by the end of the month.

While trucks and barges are an alternative means of delivering gasoline to the Chicago/Milwaukee market, it's a far more expensive method of delivery and a limited delivery alternative given the paucity of unused truck and barge capacity. The upshot is that trucks and barges have not been able to make up the shortfall in deliveries caused by the pipeline problems and the use of trucks and barges has added expense.

An imbalance of only a few percent between supply and demand seems at first blush to be a minor problem, but given the nature of gasoline markets, it is quite serious.

#### **Gasoline Economics 101**

The demand for gasoline is inelastic in the short run. That is, it takes a large increase in price to reduce consumer demand even a little in the near term. Economists calculate that short-term price elasticity for gasoline is about -0.05. That is, if prices go up 1 percent, consumer demand will decrease in the short term by only one-twentieth of 1 percent.

Accordingly, when the demand for gasoline outstrips the available supply (even by just a little), prices have to go up a lot in order to keep the gasoline pumps from literally running dry. Thus, if local gasoline supplies are 2-3 percent below where they need to be to meet unmoderated consumer demand - the figure most market analysts believe to be correct for the Milwaukee/Chicago area - price would have to jump by more than 50 percent in order to prevent spot shortages.

Prices, remember, are used to allocate scarce goods. Although demand for gasoline is far more elastic in the long run, in the short run, small disparities in supply and demand (in either direction) will always by necessity have a large impact on prices.

Thus, we know all we need to know to explain the supposed mystery of retail gasoline prices in the Milwaukee/Chicago area. OPEC production cutbacks and surging world oil demand have driven the price of oil from around \$10 a barrel in the winter of 1998/99 to around \$30 a barrel today, adding 50-60 cents to the price of gasoline per gallon. Pipeline ruptures and production shortfalls have further reduced Milwaukee/Chicago supplies by 2-3 percent, which -- given the inelasticities of demand - explains the 50 cent difference between peak regional gasoline prices and national average gasoline prices.

### **Why the Production Shortfall?**

What role have politicians played in all of this? Approximately three-quarters of the price hike in the Milwaukee/Chicago area can be explained by circumstances largely outside of government's control; the OPEC production restraint and the pipeline ruptures. This is also the conclusion of economist Lawrence Kumins in his June 16 report on midwestern gasoline prices for the Congressional Research Service.

One-quarter of the price spike, however, can be laid directly at the doorstep of government. Refineries have had a hard time keeping up with the demand for reformulated gasoline in the Milwaukee/Chicago market, and that production shortfall is a logical consequence of poorly designed federal and state policies. Refinery production has been limited by the reformulated gasoline mandate passed as part of the 1990 Clean Air Act, unnecessarily burdensome environmental regulations promulgated by the EPA, and the continued demagogic nature of Congress, which deters investment in the refining industry.

### ***Reformulated Gasoline Mandate***

As a consequence of the Clean Air Act Amendments of 1990, areas that violated federal air quality standards were required to sell only specially reformulated gasoline beginning June 1, 2000. This new gasoline is blended with various oxygenates (primarily methyl tertiary butyl ether - MTBE, or ethanol) in order to reduce the emission of carbon monoxide, a significant contributor to wintertime smog, and to reduce the amount of toxic chemicals, such as benzene, in the fuel. This reformulated gasoline now serves 30 percent of the country.

While today's reformulated gasoline (known in the regulated community as "Phase II" reformulated gasoline, or RFG-2) is 1-2 cents more expensive per gallon than last year's "Phase I" reformulated gasoline and 5-8 cents more expensive than conventional gasoline, the real consumer impact of reformulated gasoline is related to the rigidity it imposes on national gasoline markets.

The accompanying map of the United States shows the different federal requirements for retail gasoline. As of October 1999, there were essentially seven separate gasoline markets. As of today, there are eight; gasoline is reformulated with ethanol in Milwaukee and Chicago but with MTBE elsewhere.

This is a crucial point. As noted earlier, gasoline intended for ethanol reformulation requires a unique blendstock known in the trade as "RBOB." That's because ethanol evaporates easily and unburned evaporated fuel is a major contributor to smog. Gasoline intended for ethanol blending must, accordingly, be specially made in order to minimize ethanol evaporation rates.

Because of RBOB's unique characteristics, it must be segregated from other gasoline all the way up the transportation system until the point just before it is mingled with ethanol and delivered to the service station. Accordingly, it cannot move through normal distribution channels and requires an entirely separate, dedicated transportation network.

This congressionally mandated balkanization of the gasoline market has seriously hampered the flexibility that refiners would otherwise have to react to spot shortages (and the related opportunity for profit making). Because it is inefficient to segment refining operations to produce multiple fuel blends, refiners generally dedicate their facilities to the production of one particular gasoline blend. Going into the spring, most of the RBOB for the Milwaukee/Chicago market was produced by six refineries in Illinois. Unfortunately, shifting production from one blend to another is costly and time consuming. Accordingly, refiners cannot react quickly to profit-making opportunities.

Why did the refining industry initially underproduce RBOB? Two reasons. First, whenever new gasoline blends are introduced to the market, an adjustment period almost always takes place that is frequently characterized by temporary supply and transportation dislocations. Refiners and merchant facilities need time to figure out the marketplace, their place in it, and to learn the most efficient way to deliver the new product to consumers. This shakeout is temporary but inevitable. As even the EPA acknowledged in its November 1999 "Fact Sheet on Reformulated Gasoline":

It is not possible to accurately predict the retail price of Phase II RFG [reformulated gasoline] in the year 2000 because it will be influenced by many factors including production costs, weather, crude oil prices, taxes, and local and regional market conditions. *It is important to note that, at the start of the Phase II RFG program, retail prices may be higher or fluctuate more.*

Accordingly, there should be no surprise that the introduction of this fuel in the Milwaukee/Chicago area on June 1 led to problems as the industry adjusted to new market conditions. Government mandates will always produce such periods of temporary dislocation.

Second, a federal appeals court ruled in March that Unocal legitimately held a patent on the most efficient method of producing RBOB. Refiners were forced to either pay Unocal royalties on RBOB production (imposing a 1-5 cent per gallon tariff on the cost of RBOB) or use a less efficient means of producing the blend. While the direct cost of the Unocal patent is thus minor, the indirect cost has been a reduction in RBOB production. Given the low profit margin that refiners typically operate under, many refiners simply chose to dedicate their facilities to the production of other blends.

#### ***Environmental Regulatory Burdens***

As noted a moment ago, the refining business is not a particularly profitable one. Its profit margins, in fact, are smaller than the industrial average and no new refinery has been built in over thirty years. Refining capacity is shrinking annually due to plant shutdowns despite continually increasing demand.

The lack of profitability within this industry can be easily traced to several causes.

First, air pollution and hazardous waste regulations hit this particular industry harder than almost most any other. While such regulatory burdens might be justified as the



price society must pay for a cleaner environment, that is unfortunately not the case. A 1990 joint study by the U.S. EPA and Amoco found that a typical refinery could meet all of EPA's emission mandates at only 20 percent of the cost if only the federal government would allow the plant managers flexibility in how they go about controlling emissions.

Second, delays in permit review and issuance seriously constrain a refiner's ability to react to profitable market opportunities such as the one presented today by high prices in the Milwaukee/Chicago area. Retooling a plant to produce a different gasoline blend requires federal permits to ensure that no additional air pollutants would result from the change. Often, these permit reviews take so long that windows of market opportunity close before refiners are capable of taking advantage of them.

Third, the federal government is constantly issuing new orders regarding how gasoline can be made. Those orders, which require constant retooling and reinvestment in facilities, not only impose steep up-front costs but curtail a plant's ability to capture profits from previous mandated retoolings and reinvestments. The refining industry is today facing 12 major regulatory actions over the next 10 years, all of which will require major capital investments. Many of those regulatory actions concern additional mandated changes in gasoline blends such as the reduction of sulfur in gasoline and diesel fuel, total elimination of MTBE from reformulated gasoline, and the reduction of various toxic substances. These changes alone will cost between \$1.8 billion and \$5 billion depending upon how the regulations are promulgated by EPA.

As long as government is insensitive to the regulatory costs it's imposing on this industry, it cannot legitimately complain when the industry occasionally stumbles under the weight of its regulatory burdens. In short, the government has made certain that there is little profit to be made in the business of refining gasoline, capacity is naturally dwindling, and the industry's ability to quickly and efficiently adjust to dislocations caused by new mandates is disappearing.

#### ***Regulatory Uncertainty***

The final contributing factor to the shortfall of gasoline this summer is the constant threat of regulatory and policy change that deters companies from entering the market, investing in efficient practices and technologies, or stockpiling supplies. If businessmen are uncertain about whether new regulations will be imposed that might prevent them from recouping the cost of plant investments, less plant investment will be made. Similarly, if politicians threaten to impose windfall profit taxes or other forms of regulatory intervention to ensure that occasional shortages never present the opportunity for significant profit, then companies will refrain from investing in stockpiling and other activities that only prove profitable under such conditions.

It is a cardinal rule of economics that stable rules are good rules. Even poorly drafted, inefficient regulations can be mitigated and overcome in time by market actors. Constant change, however, spawns uncertainty, and uncertainty in the marketplace restricts corporate time horizons in ways that often prove disastrous for consumers.

#### **The "Price Gouging" Charade**

The foregoing analysis should put to rest the charge that oil companies are "gouging" the public. Price increases in the Milwaukee/Chicago region were necessitated by a shortfall in supply, a shortfall that was caused by a number of factors. Moreover, there is no dispute about the fact that there *has been* a shortfall. The fault line is between those who understand that, given the inelasticities of demand, such a shortfall will have major pricing implications and those who simply do not understand the basic economics of this industry.

Even so, the logic of the "price gouging" charge is threadbare. Federal regulatory officials deny the possibility of shortages by pointing out that reformulated fuel stocks are just as plentiful today as they were last year when no such price shock occurred. But demand is about 4 percent higher today than last year, a disparity that is great enough to trigger the spike. Moreover, such assertions about overall reformulated fuel stocks ignore the fact that the particular reformulated fuel stock relied upon by the Milwaukee/Chicago market -- RBOB -- is undeniably in shorter supply.

Spectacularly high industry profits are not evidence of gouging. Given the inelasticities of consumer demand for gasoline, prices had to go up substantially to bring demand in balance with supply. If they had not, then the Milwaukee/Chicago area would have undergone a replay of the 1970s when long gasoline lines and dry service station pumps traumatized the nation. Suppliers who had gasoline for the Milwaukee/Chicago market on hand and who were able to deliver it cheaply to market (inframarginal suppliers) are indeed making a substantial profit. Those who had to retool their refineries this spring to make RBOB for the Milwaukee/Chicago market and those who had to secure special truck or barge service to get that gasoline to market (extramarginal suppliers) are making significantly less.

Regardless, those high prices were necessary not only to ration a scarce good; they were also necessary to signal to other refiners that a valuable commodity was in short supply. If prices had somehow been kept down by government action, refiners would have been even less likely to help mitigate the shortage and the supply crisis would have been even worse.

Finally, the charge of price gouging has little internal consistency. If oil companies have enough market power to gouge consumers at will, why have they waited until this year to exercise that power? Why did they not "gouge" in 1999, or in 1998 (when industry profits were at their lowest point in years), or anytime over the last several decades? Moreover, why would oil companies gouge the Milwaukee/Chicago area but nowhere else?

The answer some give is that the industry needed an "excuse" to gouge, and the introduction of Phase II ethanol-blended reformulated gasoline this June was the excuse they needed and an excuse that was not available in any other market. But what critics miss is that businesses do not need an "excuse" to raise prices if that's what they want to do. This is, after all, a relatively free market and companies are free to charge whatever they think the market will bear anytime they chose.

Oil companies should not have to apologize for their profits this year. Given the short-term inelasticities of both supply and demand in this industry, minor imbalances in *either* direction will dramatically move prices either up or down. Massive but

temporary transfers of wealth are just as likely to benefit consumers as they are to benefit producers in the oil business because temporary periods of excess supply are as likely as are temporary shortfalls of supply. Nobody shed a tear when consumers were "gouging" oil companies in 1998 when the short-term inelasticities of the gasoline markets crashed prices through the floor. Nobody should shed a tear now when those same market inelasticities produce windfall profits for producers.

Finally, for a charge of price gouging to have credence, federal investigators will have to find evidence of collusion between oil companies. That's because no one company has enough market power to unilaterally drive up prices. But absolutely no evidence of collusion has been unearthed so far, and 30 years of on-again, off-again public witch-hunts have yet to produce even a shred of evidence that oil companies have ever colluded to fix prices.

The belief that oil companies get together to profit at the expense of consumers appears to be genetically hard-wired into our heads. But much like the belief in extraterrestrials, it has yet to be substantiated. Given the perfectly understandable nature of the current price spike in the Milwaukee/Chicago area, it's a pretty safe bet that this particular investigation by the Federal Trade Commission -- like all investigations that have come before it -- will turn up empty. It is my hope, however, that those who are so demagogically accusing the industry of unjustified profiteering without any evidence will just as loudly and energetically apologize to it once the FTC investigation concludes with its inevitable findings.

### Conclusion

Of the approximately \$1 per gallon increase in gasoline prices that Milwaukee/Chicago area drivers have experienced over the past year, about 50 cents can be attributed to OPEC production decisions, 25 cents can be attributed to unfortunate pipeline breaks during particularly inopportune times, and 25 cents can be attributed to the market complications imposed by the reformulated gasoline mandate originally imposed in the 1990 Clean Air Act and put into place this June.

Congress would be best advised to eliminate the reformulated gasoline mandate in its entirety. Not only has it been responsible for an (albeit largely temporary) 25 cent per gallon increase in gasoline prices, it accomplishes absolutely nothing in the way of air quality. The fuel injection systems that replaced conventional carburetors in cars built since 1983 include computerized oxygen sensors to determine when the fuel-air mix is optimized from an emissions perspective. By automatically mixing gasoline in such a way as to minimize carbon monoxide emissions, fuel injectors accomplishing through technology what the mandated reformulated gasoline attempts to accomplish via fuel design. Eric Stork, the head of EPA's Mobile Source Air Pollution Control Program from 1970 till 1978, told the *New York Times* recently that reformulated gasoline was a good idea 30 years ago, but in cars built in 1983 or later, the fuel is "obsolete and pointless."

Congress should also demand that environmental regulations shift from a command-and-control basis to a "performance" based regime. Federal agencies might still require that no more than x amount of this or that pollutant come from a facility or gasoline blend but should allow plant managers to undertake whatever actions they wish to meet the standard. As long as companies are required to verify their

Page 9 of 9

emissions (and allow public verification of their findings), such a regulatory reform would dramatically reduce regulatory burdens on refiners while maintaining current strict air quality standards.

Finally, congress should force regulatory changes to expedite the issuance of federal air emission permits and reconsider the onslaught of new fuel recipe mandates that are in the hopper. As a recent report by the National Petroleum Council (an official advisory body to the secretary of the Department of Energy) warned, those mandates threaten to replay the dislocations that have hit the Milwaukee/Chicago market in other markets on and off for years to come.

Thank you for your patience, and I look forward to answering any questions you may have.

**EXHIBIT XXVII****EPA Office of Mobile Sources Fact Sheet on RFG, November, 1999**

The EPA fact sheet on reformulated gasoline describes the history of the program as well as its basic elements. The fact sheet also provides an estimate of the increased cost associated with RFG production and states, "at the start of the Phase 2 RFG program, retail prices may be higher or fluctuate more."

**Emission Facts****Reformulated Gasoline**

*Reformulated gasoline (RFG) is gasoline blended to burn cleaner and reduce smog-forming and toxic pollutants in the air we breathe. About 75 million people are breathing cleaner air because of RFG. The second phase of the RFG program, which will begin in 2000, will achieve even greater reductions in air pollution than Phase I RFG.*

**History of RFG**

Despite tremendous progress in reducing U.S. air pollution since the Clean Air Act was passed almost 30 years ago, cars and trucks are still a major source of pollution because the number of cars and trucks and the number of miles driven keeps growing.

One way to reduce air pollution from cars and trucks is to use a gasoline that is designed to burn cleaner. This cleaner burning gasoline, called reformulated gasoline or RFG, is required by the Clean Air Act in cities with the worst smog pollution, but other cities with smog problems may choose to use RFG. The federal RFG program was introduced in 1995; RFG is currently used in 17 states and the District of Columbia. About 30 percent of gasoline sold in the U.S. is reformulated. Each oil company prepares its own formula that must meet federal emission reduction standards.

The RFG program is a significant step toward cleaning the air we breathe, and a significant component of the country's smog reduction strategy. RFG's air quality benefits, combined with other industrial and transportation controls aimed at smog reduction, together are responsible for the long-term downward trend in U.S. smog.

**Air Quality Benefits of RFG**

The first phase of the RFG program was designed to reduce the air pollution that causes smog by 64,000 tons per year in the areas that use RFG, compared to conventional gasoline. The equivalent of eliminating the smog-forming emissions from over 10 million vehicles.

When the more stringent standards of Phase II RFG replace Phase I in 2000, the program is designed to reduce smog pollutants by an additional 41,000 tons per year in RFG areas, for a combined equivalent of eliminating the smog-forming emissions from about 16 million vehicles.

The RFG program also reduces emissions of toxic air pollutants such as benzene, a known human carcinogen. Phase I and Phase II RFG combined reduce toxic pollutants by about 24,000 tons per

year in RFG areas, the equivalent of eliminating the toxic emissions from over 13 million vehicles.

A study by the Northeast States for Coordinated Air Use Management, an organization of state air quality experts, shows that Phase I RFG reduced cancer risk from gasoline by about 12 percent, and Phase II RFG is expected to reduce cancer risk by 19 percent.

Analysis of fuel data submitted to EPA by industry for compliance purposes shows that emission reductions from the RFG program have been more than the program requires each year since the program's introduction in 1995.

### **Performance and Fuel Economy**

EPA conducted a fleet testing program in 1998 to evaluate car and truck performance with Phase II RFG, compared to Phase I RFG. Testing took place in Boston, Chicago, and Houston. The test fleet drove over one million miles with Phase II RFG. Performance testing was also conducted in 1998 with utility, lawn, and garden equipment, and with motorcycles and marine engines. In addition, EPA sponsored fuel economy testing with Phase II RFG, compared to Phase I RFG.

All available data indicate that no difference in car or truck performance or fuel economy is expected when Phase II RFG replaces Phase I RFG. In addition, no difference in performance is expected with utility, lawn, and garden equipment, or with marine engines or motorcycles.

Note that changing from conventional gasoline to RFG, which is oxygenated, results in a one to three percent fuel economy loss; that is less than one mile per gallon for a vehicle that gets 25 miles per gallon. However, there is no additional oxygenate in Phase II RFG compared to Phase I, so there is no additional fuel economy loss.

### **Production Cost and Retail Price**

Prior to the introduction of Phase I RFG, EPA estimated that the cost to industry to produce the fuel would be about three to five cents per gallon more than conventional gasoline. The Lundberg survey, conducted by an independent market research firm, concluded in October 1997 that RFG's retail price has been about three cents per gallon more than conventional gasoline. The retail price does not necessarily reimburse all production expenses.

EPA estimates that Phase II RFG will, on average, cost one to two cents per gallon more to produce than Phase I RFG. In some parts of the country and for some refiners, production costs could be higher. It is not possible to accurately predict the retail price of Phase II RFG in the year 2000 because it will be influenced by many factors, including production costs, weather, crude oil prices, taxes, and local and regional market conditions. It is important to note that, at the start of the Phase II RFG program, retail prices may be higher or fluctuate more.

### **Oxygen Requirement**

In the Clean Air Act, Congress specified that RFG contain oxygen — two percent by weight. MTBE (methyl tertiary butyl ether) and ethanol are the two most commonly used substances that add oxygen to gasoline. Oil companies decide which substance to use to meet the law's requirements.

Leaking storage tanks are the number one cause of gasoline contamination of water. Small spills and improper disposal are also sources of contamination.

Many chemicals in gasoline—including MTBE—can be harmful in water. MTBE is highly soluble and travels faster and farther in water than other gasoline components.

MTBE has a strong taste and odor, so even small amounts of MTBE in water can make a water supply distasteful. In most cases where MTBE has been detected, MTBE concentrations are below levels of public health concern. At high levels, MTBE may pose a public health threat. EPA's MTBE advisory level for taste and odor is 20 to 40 parts per billion.

EPA is concerned about the presence of MTBE in ground and surface water. In November 1998, EPA established a panel of independent scientists and other experts to examine MTBE's performance in gasoline, its presence in water, and alternatives to its use. Panel recommendations made to EPA in July 1999 include:

- Ensure no loss of current air quality benefits from RFG.
- Reduce the use of MTBE, and seek Congressional action to remove the oxygen requirement in RFG.
- Strengthen the nation's water protection programs, including specific actions to enhance the Underground Storage Tank, Safe Drinking Water, and private well protection programs.

EPA has announced its intention to work with Congress to provide a targeted legislative solution that maintains the air quality benefits of RFG while allowing reductions in the use of MTBE. EPA will also protect water supplies by improving gasoline leak protection and remediation programs.

### For more information

Additional documents on RFG are available electronically on the Office of Mobile Sources Internet site at:

<http://www.epa.gov/oms/rfg.htm>

Document information is also available by writing to:

U.S. Environmental Protection Agency  
Office of Mobile Sources  
NVFEL Library  
2000 Traverwood Drive  
Ann Arbor, MI 48105

---

[\[OMS Home\]](#) [\[EPA Home\]](#) [\[Related Links\]](#) [\[Air Quality\]](#) [\[Search\]](#) [\[Comments\]](#)

url: <http://www.epa.gov/oms/>

Last update: 11 Feb 99



Washington Office  
1440 New York Avenue, N.W.  
Suite 200  
Washington, D.C. 20005  
202 942-2050  
FAX 202 783-4796

July 18, 2000

The Honorable Thomas Bliley  
Chairman  
House Commerce Committee  
2125 RHOB  
Washington, DC 20515

Dear Chairman Bliley:

AAA appreciated the recent opportunity to testify before the House Commerce Committee regarding the impact of high gasoline prices on consumer travel behavior. We were pleased to be able to represent the viewpoints of motorists across the country and provide the travel data we had compiled regarding the impact of gasoline prices on travel and vacation trends.

Representative Tauzin concluded the hearing by requesting that panelists take the opportunity to provide additional information for the record as to possible actions that could be taken to remedy the gas price situation. AAA believes your committee attention to this matter is most important.

First, domestic crude inventories remain at extremely low levels. This trend has emerged over the past decade, during which time AAA stressed repeatedly to the Administration that this would inevitably contribute to the type of market distress we have been experiencing. AAA believes that refiners must enhance production and increase crude inventory or the US will continue to remain at the mercy of the OPEC cartel and to other supply disruptions.

Second, in correlation to the problems associated with low domestic inventory, the Strategic Petroleum Reserve should be expanded and the conditions under which the President is authorized to draw down from the reserve broadened. There also should be in place a workable plan for the immediate sale of oil from the SPR in a declared fuel emergency.

Third, accusations of zone-pricing, whereby oil companies could conceivably distort the market by varying prices from region to region, must be examined and monitored. Reliance on the principles of competitive free enterprise has historically served this country well and should be the primary consideration in establishing market prices.

Fourth, there continues to be an overall lack of a comprehensive energy policy in the United States. While there are controversial issues associated with the problem of low domestic production and



The Honorable Thomas Bliley  
July 18, 2000

Page 2

inventory, such as the case for drilling in the Arctic National Wildlife Reserve, there are measures which can be implemented that do not provoke impassioned or negative responses. For example, AAA supports government efforts to work with the private sector to develop alternative fuel and vehicle programs. We would also encourage further research into fuel cell and battery technology as well as other low or zero-emissions vehicle technologies.

At the same time, AAA recognizes that it is equally important to have educated consumers, and that drivers must do their part to conserve fuel and operate their vehicles in a more energy efficient fashion. We will continue to provide our membership with the information they need to be better informed about how to reduce the demand side of the equation through publications like our "AAA Gas Watchers Guide."

Finally, in conjunction with the development of an energy policy, AAA believes the Department of Energy should be the primary federal agency to implement such a strategy. While environmental regulations are important and necessary, it is equally important that the US have a coordinated, forward-looking strategy: one that promotes domestic energy sources and seeks to enhance US competitiveness rather than contributing to unacceptable economic distress, as illustrated by the extraordinary increase in gasoline prices in areas of the Upper Midwest. The confusion and accusations aired at the committee hearing regarding the impact of reformulated gasoline (RFG) in Chicago and Milwaukee made clear the need for a more coordinated effort among federal agencies. Consumers should not be the victims of disruptions which the federal government cannot adequately explain. That is why AAA supported a 90-day moratorium on the RFG program in order for the Administration to sort out the causes for the high gas prices and provide consumers with interim relief.

Once again, thank you on behalf of AAA for the opportunity to provide testimony to the Commerce Committee. Please do not hesitate to contact us if you have any questions or require additional information.

Sincerely,



Mark H. Brown  
Executive Vice President  
AAA



ENERGY SERVICES  
One Williams Center  
P.O. Box 3448  
Tulsa, Oklahoma 74101  
918/573-2000

July 17, 2000

The Honorable Thomas Bliley  
Chairman  
House Commerce Committee  
U.S. House of Representatives  
Washington, D.C. 20515

Ethanol Shipments in Pipelines

Dear Representative Bliley:

During a June 28<sup>th</sup> Commerce Committee hearing on gasoline prices, Members raised questions about the capacity to ship ethanol in pipelines. Given the amount of interest in this matter, we are writing to offer our first hand knowledge of transporting ethanol.

Williams Transportation & Terminals owns and operates over 9,100 miles of refined products pipeline in America today. Moreover, Williams operates:

- ♦ 75 product terminals with 44 MMbbl storage capacity -- over 40 terminals offer ethanol
- ♦ 227,000 bbl/d refining output capacity
- ♦ 190 million gallons per year ethanol capacity


Fuel grade ethanol can be shipped in a refined products pipeline. In fact, ethanol is transported long distances via pipeline today in Brazil. Here in the U.S., a West Coast refiner has recently announced plans to transport ethanol via pipeline from a marine terminal to inland terminals. Supply chain stakeholders, including refiners, are likely to increase their use of pipelines to transport ethanol as pending legislative and regulatory issues are resolved. In other words, once refiners make decisions regarding the timing of large-scale ethanol blending programs, stakeholders may be more likely to take advantage of the positive benefits of ethanol pipeline shipments.

To review the feasibility of ethanol shipments in a refined products pipeline, Williams conducted a test in 1981. The conclusion of the test is as follows:

...“our experimental pipeline tests indicate that fuel grade ethanol can be successfully transported in a multi-products pipeline system under controlled conditions. The greater the frequency of batches through any system through any given line segment, the fewer the quality problems that we would expect to experience.”

In our opinion, any technical and operational issues associated with ethanol shipments in a multi-products pipeline can be overcome. We have proven this with our own experience, and submit to you a copy of our ethanol test findings.

Sincerely,

A handwritten signature in cursive script, appearing to read "Michael Mears".

Mike Mears  
Vice President  
Williams Transportation & Terminals

cc: The Honorable John Dingell  
The Honorable John Shimkus

attachment

Transportation of Fuel Grade Ethanol by a Multi-Products Pipeline

Shortly after the introduction of gasohol into the marketplace, considerable interest focused on satisfactory distribution of this fuel, including pipeline transportation. Inquiries were numerous to us at Williams Pipe Line Company on the feasibility of pipelining such a blend and also the handling of neat fuel grade ethanol. After identifying the anticipated problems associated with such a movement, our response was merely that we have the system and would be willing to co-sponsor a test run with anyone wishing to supply the ethanol product.

A major alcohol producer indicated an interest in such a study and together we planned an experimental test batch line movement from our Kansas City terminal to our Des Moines terminal. Our planning addressed the major anticipated problems, namely, water pick up, color degradation and absorption of normal pipeline residues into the alcohol product.

Because of limited supply of ethanol, an 8-inch line segment was chosen that would allow pumping from ethanol tankage at Kansas City and receiving into ethanol tankage at Des Moines. This line segment was laid in the early 1930's and in later years primarily transported distillate fuels. Recognizing that distillate usage has the potential of depositing greater quantities of hydrocarbon residues, as compared to gasolines, our plans included a series of scraper runs to mechanically remove as much residue, sediment and water as possible. The line was also switched to gasoline service some ten days before the alcohol test run.

Scrapers, or pigs, were launched from Kansas City in the gasoline product. This clean up resulted in an estimated removal of 130 barrels of water and sludge from the line. Analysis of this sludge revealed the following approximate composition:

Water	52%
Ethanol Solubles	11%
Ethanol Insolubles	57%

If this 130 barrels of sludge were to be absorbed into a 5,000 barrel ethanol shipment, we can estimate its effect on ethanol quality as follows:

Increase in Water	0.82%
Increase in Ethanol Solubles	0.30%
Increase in Ethanol Insolubles	1.50%
Ethanol Color	8 ASTM

The quality of ethanol used in the mainline test met Williams' fungible or common specification for fuel grade ethanol that is loaded from six of our company-owned terminals. This specification is given in the following table.

Apparent Proof, Min., 60°F	201
*Denaturant Formulation (BATT Regulations)	CDA-20
Water, max., volume percent	0.5
Color, max.	0.5 ASTM

\*Denaturant used shall be hydrocarbon solvent or unleaded gasoline, or any combination of these. E-grade ethanol shall contain no impurities such as

We may conclude from these results, that water pick up was negligible with the major differences being in the areas of color and gum. Blends of gasohol were prepared from both alcohols, origin and destination, and critical quality parameters measured. The results were as follows:

	<u>Original Alcohol</u>	<u>Pipeline Exposed Alcohol</u>
Water tolerance, Class V	Pass	Pass
Research Octane Number	95.8	95.8
Motor Octane Number	84.4	84.4
(R+M)/2	90.1	90.1
Exist., Gum, mg/100 ml	1.0	3.2
Color, Visual	Lt straw	Brown/Bronze

These test results suggest both fuels meet accepted specification requirements.

In summary, our experimental pipeline tests indicate that fuel grade ethanol can be successfully transported in a multi-products pipeline system under controlled conditions. The greater the frequency of batches through any given line segment, the fewer the quality problems that we would expect to experience.

- (8) Frequent monitoring of octane quality from all delivery points is suggested as a check against the loss of ethanol due to any handling problems during the transportation cycle.

There may be other concerns as well, however, these are major for common carrier pipeline systems that contemplate handling ethanol/hydrocarbon fuels from refinery sources.



Renewable Fuels Association  
One Massachusetts Avenue, NW  
Suite 820  
Washington, DC 20001

202 289 3835  
(t) 202-289-7519  
[http://www](http://www.rfa.org)  
email: [etol](mailto:etol@rfa.org)

Testimony of  
Eric Vaughn  
President and Chief Executive Officer  
Renewable Fuels Association

Before the  
House of Representatives  
Committee on the Judiciary

Washington, D.C.  
June 28, 2000

Good morning Mr. Chairman and Members of Committee. I want to thank you for the opportunity to present testimony this morning regarding the current gasoline price situation in the Midwest and the role of ethanol. This is a timely and critically important hearing. The causes for the unacceptably high gasoline prices in the Midwest are numerous, and ethanol can help both in the near term as the Midwest begins to address soaring gasoline prices and the long term as the United States develops a more responsible and proactive energy policy.

The Renewable Fuels Association is the national trade association for the domestic ethanol industry. Our membership includes ethanol producers, gasoline marketers, farm organizations and state agencies dedicated to the continued expansion and promotion of fuel ethanol. The ethanol industry produced approximately 1.5 billion gallons of ethanol last year from a variety of feedstocks, including corn, wheat, potatoes, beverage waste, wood waste, and other biomass. We are on a pace to break all previous production records in 2000 as production capacity continues to expand, particularly among farmer owned cooperatives, the fastest growing segment of our industry.

**Background:**

Fuel costs across the Midwest have risen dramatically over the past year, particularly since May when several fuel supply disruptions created product shortages in many areas. As noted in the attached chart, however, prices of conventional gasoline, reformulated gasoline (RFG) and MTBE have been rising steadily since June 1999. Chicago conventional gasoline has risen 127%, from \$0.54 to \$1.23 per gallon; Chicago ethanol RFG has risen 106%, from \$0.60 to \$1.24; and MTBE has risen 130%, from \$0.68 to \$1.56. At the same time, ethanol prices have risen just 29%, from \$0.55 to \$0.71.

*The Renewable Fuels Association is the national trade association for the domestic ethanol industry*

With a net cost of just \$0.71 per gallon, ethanol is the most cost-effective liquid transportation fuel available in the Midwest today. Because of its high octane and emissions benefits, refiners can displace 10% petroleum at a cost of \$1.24 and replace it with ethanol, saving approximately \$0.053 per gallon (\$0.124 minus \$0.071). Thus, at least a partial solution to the current gasoline price crisis in the Midwest is the increased use of fuel ethanol.

#### **Current Gasoline Price Crisis**

Gasoline prices are a function of many factors: crude oil prices, manufacturing costs, supply distribution and market dynamics (i.e., bidding). In this case, the rising cost of crude oil is at the heart of the problem. Since January 1999, crude oil prices have risen more than \$20, to over \$32 per barrel. This, alone, has given rise to about a \$0.50 increase in per gallon gasoline prices. But more importantly, it has created a significant disincentive for refiners to build inventory. European and U.S. gasoline stocks are at ten-year lows. In fact, gasoline stocks are so low that readily available gasoline in the U.S. today is the equivalent of slightly less than two days of current consumption.

Indeed, this is a practice that makes sense for the shareholders of major international oil companies. But it leaves consumers vulnerable to even minor disruptions in supply or production. For example, just last summer consumers in California were facing the highest gasoline prices in the nation because "just-in-time" inventory could not satisfy the increased demand that occurred when 7% of the state's gasoline production capacity was shut down by a refinery fire.

In this case, refiners in the Midwest have been unable to recover from three separate supply disruptions that occurred when critical pipelines supplying the region were temporarily shut down. Again, the "just-in-time" inventory practices of the refining industry left consumers vulnerable. When supplies are tight, market dynamics bid the price of gasoline higher than economic principle would dictate.

We believe this is supply mismanagement of the worst kind. Had refiners built inventory sufficient to accommodate typical disruptions, the tight supply situation that has caused price bidding in the Midwest would not have occurred. Importantly, as the quarterly profit reports from the oil industry will demonstrate, the only winners in this situation are the companies that caused the problem to begin with by failing to assure adequate gasoline supplies.

What's worse, rather than simply admitting their mistake, the refining industry appears intent on assigning blame elsewhere. It's OPEC. It's EPA regulations. It's the ethanol industry. Indeed, the representatives of the major oil companies would have us believe they are innocent victims of circumstances beyond their control. Again, the soon-to-be-released quarterly corporate profit reports should shed some light on the real victims here — consumers.

**The Role of Ethanol RFG:**

As noted, according to spokespersons for the American Petroleum Institute (API), the logistical burden and cost of ethanol RFG is primarily responsible for the current price situation in the Midwest. But such suggestions lack any factual basis and appear more motivated by politics than economics. Let's look at the facts.

First, refiners have known about the Phase 2 RFG requirements for more than six years and have never suggested they would lead to such significant price increases or supply shortages. Refinery modeling completed for the RFA by The Pace Consultants, Inc. of Houston, Texas, concludes the incremental cost associated with producing ethanol reformulated gasoline blendstock for oxygenate blending (RBOB) is approximately \$0.007 per gallon.

Second, the cost of conventional gasoline without ethanol in the Midwest has been rising as steadily as reformulated gasoline. Indeed, while RFG wholesale prices have risen 34% since May, conventional gasoline prices have risen 30%. One area experiencing some of the highest gasoline prices today is Detroit, an area without RFG and little ethanol blending. If ethanol RFG were the cause, why are these conventional gasoline markets also seeing such inordinately high prices compared with the rest of the country?

Third, ethanol RFG is also being sold in St. Louis and Louisville at lower costs than MTBE blended RFG being sold in those areas and significantly less than the ethanol RFG being sold in Chicago and Milwaukee. St. Louis and Louisville are southern RFG cities. Chicago and Milwaukee are northern RFG cities. While the specific regulatory requirements are similar, they are not the same. The southern RFG must meet a more stringent VOC performance requirement, meaning that the ethanol RFG being sold in St. Louis is more difficult to make than the fuel being produced for Chicago. Thus, if the cost of producing ethanol RFG is the cause of the problem, why is ethanol RFG being sold in St. Louis and Louisville less costly for consumers?

Ethanol is not part of the problem. It is part of the solution.

**Carbon Monoxide Credit:**

The Clean Air Act's RFG program was initiated to reduce ozone from the nation's worst polluted cities. Urban ozone formation occurs when hydrocarbons react with NOx and carbon monoxide in the presence of sunlight. Oxygenates, such as ethanol, reduce all pollutants – ozone-forming hydrocarbons, NOx, air toxics and carbon monoxide. The RFG requirements include specific performance standards for hydrocarbons, NOx and air toxics, but did not include a performance standard for carbon monoxide.

The National Research Council last year reported that carbon monoxide emissions account for as much as 20% of the ozone attributable to motor vehicles. EPA's existing regulatory framework for RFG, however, fails to account for the contribution of carbon monoxide to ozone formation. As a consequence, refiners are given no credit for the extra ozone reduction attributable to 10%-ethanol blended RFG which has a higher oxygen content and thus greater carbon monoxide reduction than other RFG fuels. If



EPA's regulations could account for this extra benefit, it would be easier for refiners to produce ethanol RFG.

As noted earlier, the incremental additional cost of ethanol RFG blendstock is small. But if the blendstocks for ethanol RFG were more similar to fuels being sold in other RFG areas, the products might be more fungible and could be more easily transshipped from one RFG area to another when supply disruptions occur. Certainly, were it not for the fact that Chicago/Milwaukee RFG is a specialty product with only six refiners currently producing the blendstock, it is likely the market would have responded more quickly and easily to the tight supply situation at the heart of the Midwest RFG price situation.

Moreover, from an environmental perspective, it makes no sense for EPA to continue to ignore the impact of carbon monoxide on urban ozone formation. EPA should act soon to provide a meaningful carbon monoxide credit. A proposal was submitted to EPA by the State of Illinois last year. Mr. Chairman, you have been one of the champions of that proposal. EPA should act on Illinois EPA's formulation for a carbon monoxide credit immediately. While its impact on the current price crisis is likely small, recognizing the contribution of carbon monoxide to ozone formation is sound environmental policy and it should be done.

#### **Ethanol Can Help**

After the Explorer Pipeline fire in March, the pipeline company and the U.S. Department of Transportation agreed to reduce operating pressure by 20%. This has resulted in a volumetric reduction of approximately 10%. This is volume that could be partially made up with increased ethanol blending. The domestic ethanol industry has alerted oil companies selling conventional gasoline in the Midwest that we are prepared to provide increased volume in this area as soon as necessary.

While U.S. refiners have just two days of demand in storage, the domestic ethanol industry has been building stocks in anticipation of increased demand as MTBE use is reduced in response to the growing MTBE water contamination crisis across the country. In fact, according to EIA, there is approximately 250 million gallons of ethanol currently in storage. That is the equivalent of almost a 45-day supply at current usage.

Moreover, the domestic ethanol industry is producing at a record pace. This year we will likely shatter all previous production records, with more than 1.6 billion gallons. We are prepared to meet the challenge for Midwest fuel supplies – today. All we need are oil companies willing to displace some of their petroleum and provide consumers with a high octane, low cost alternative fuel – ethanol.

Expanding the extent of ethanol blending in conventional gasoline would be the most timely and effective means of increasing liquid fuel supplies and lowering consumer costs across the Midwest. Again, we call on oil companies in the Midwest to consider this option today.

### U.S. Energy Policy

The current gasoline price crisis in the Midwest is only a symptom of a larger disease – an epidemic caused by a failed energy policy. Our foreign policy, our defense policy and our economic policy are still largely dictated by our nation's desperate need for oil. Until the U.S. gets serious about energy, and is prepared to do more than saber rattle and beg oil sheiks for increased supplies, our nation will be vulnerable to the kind of supply mismanagement that has stricken the Midwest.

While most of us can remember the lines at gasoline stations during the mid-70's, we have been lulled into a false sense of energy security by the lower gasoline prices of the past decade. Fundamentally, however, we are as hostage to the whims of OPEC today as we were during the height of the energy crisis that threw our economy into a tailspin 25 years ago. In fact, we are even more dependent now than we were then. In 1973, the United States imported just slightly more than 30% of domestic consumption. Today, we are importing almost twice that amount. As noted by the American Petroleum Institute recently on its web site:

“We import some 55 percent of our crude oil, meaning that we are at the mercy of foreign oil producing companies.”

Indeed, as a nation our priorities are misguided. Consider, for example, that the United States spends more money to develop, test and manufacture a single jet fighter engine than is spent annually on the development of alternative fuels. While that jet fighter may one day be used to protect the free flow of oil from the Strait of Hormuz, a more efficient use of the taxpayers' money might be to assure that jet fighter doesn't need to be there in the first place. In a recent letter to the Senate signed by General Lee Butler, USAF (Ret.), Former Commander, Strategic Air Command & Strategic Air Planner, Desert Storm; Robert McFarlane, Former National Security Advisor; R. James Woolsey, Former Director, Central Intelligence; and Admiral Thomas Moorer, USN (Ret.), Former Chairman, Joint Chiefs of Staff:

“Sitting on only 3% of the world's reserves while using 25% of the world's oil, nothing could be more short-sighted than for Americans to abandon the incentives for producing transportation fuels from sustainable sources. Such an abandonment would entrust the future of our energy supplies, and of key aspects of our security, to the potpourri of psychopathic predators, such as Saddam [Hussein], and vulnerable autocrats who control over three-quarters of the world's future supply of oil.”

We sent our sons and daughters to fight in the Gulf War to protect the free flow of oil from the Middle East. That must never be allowed to happen again. We must develop and implement a domestic energy policy that promotes the expanded production and use of domestically produced, sustainable renewable fuels such as ethanol. Without it, we will continue to rely on rogue nations for our insatiable appetite for Middle East oil, and consumers will continue to remain vulnerable to price shocks and exaggerated energy costs.

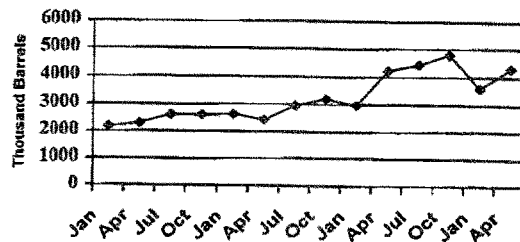
**Conclusion:**

The cause of the current gasoline price crisis in the Midwest is quite simple: with \$32 per barrel oil, refiners gambled with "just-in-time" supply management and lost. Consumers are now paying the price. With less than two days of available gasoline stocks, there is simply not enough supply to accommodate any disruptions in logistics or production. Refiners created a tight supply situation, and are now reaping the profits.

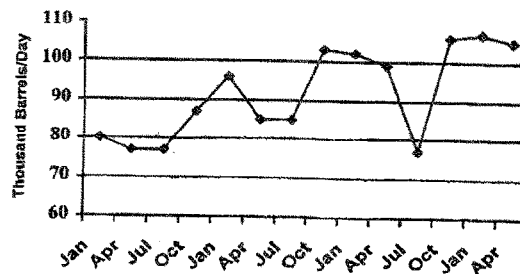
Congress should thoroughly investigate the impacts to consumers resulting from "just-in-time" inventory practices and take steps to assure greater available supplies. In the short term, ethanol remains an option to increase liquid fuel supplies and reduce consumer gasoline costs throughout the Midwest. But ultimately, Congress should take far more aggressive steps to formulate a national energy policy that will lead us to energy and economic independence. Renewable alternative fuels such as ethanol are part of the solution, both today and in the future.

Thank you.

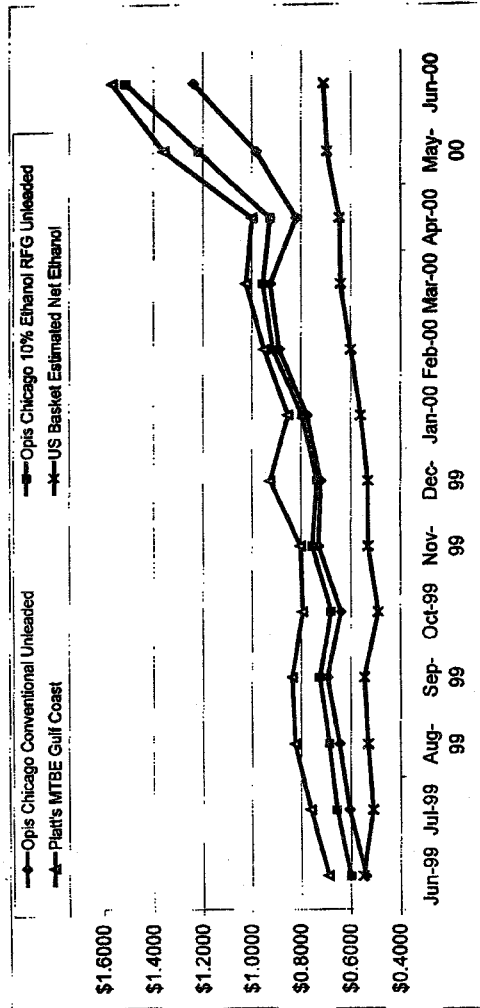
**Ethanol Stocks, 1997-2000**



**Ethanol Production, 1997-2000**



**Comparative Midwest Fuel Prices  
June 1999 – June 2000**



STATEMENT BY THE  
NATIONAL CORN GROWERS ASSOCIATION  
BEFORE THE  
COMMITTEE ON GOVERNMENT REFORM  
U.S. HOUSE OF REPRESENTATIVES  
June 28, 2000

---

Mr. Chairman and members of the committee, thank you for the opportunity to discuss the impact of rising gas prices on farmers and our perspective on the right solution to this preventable problem.

My name is Doug Wilson. I am a farmer from north central Illinois and immediate past president of the Illinois Corn Growers Association. I am also a former board member for the National Corn Growers Association and I serve on the NCGA Public Policy Action Team. I am testifying this morning on behalf of NCGA and more than 30,000 farmers in 48 states who make up the association's membership.

Let me make one thing clear right off the bat - no group suffers more from skyrocketing fuel prices than farmers. This year, the typical corn farmer will pay a whopping \$5,000 more for fuel than he or she did last year. For many of us, especially family farmers like myself - that's a giant chunk out of our wallets. It will have a devastating impact on our ability to make ends meet.

Why has this occurred? Because fuel costs have increased phenomenally since last year's harvest. At my local petroleum supplier in Livingston County, Illinois, the price of gasoline has increased 64 percent, and the price of diesel fuel is up 73 percent. Most of our equipment is made to run on diesel - in fact, U.S. agriculture uses almost four billion gallons of diesel fuel every year. Consequently, American farmers will be spending approximately \$2 billion more to plant and harvest this year's crop.

And, as these higher fuel prices persist, we are looking at higher costs for agricultural chemicals and farming fuels and supplies as well. For instance, the cost of anhydrous ammonia, one of the most-used fertilizers for corn, is up \$50 per ton in my area just the last five weeks. This is because of increasing demand for the natural gas from which it is made.

Farmers are paying through the nose despite a record in energy conservation that is second to none. By switching to more fuel-efficient machinery, adopting conservation practices, reducing tillage and becoming smarter about pest management, farmers' energy consumption has declined by nearly 30 percent since 1978. At the same time, corn yields have increased more than 22 percent. We are doing everything we can - and then some - to be environmentally responsible and hold down our costs while maximizing our productivity.

So let me repeat – there is no one out there with a greater stake in reducing energy costs than American farmers. Which is why we want to be doubly and triply sure that any action Congress takes addresses the real causes of the problem.

Let's start with what is most assuredly *not* the cause of the problem – Phase 2 of the Clean Air Act's reformulated gas (RFG) program.

Big Oil would have you believe that consumers have been paying \$2.30 a gallon and more for gasoline in the Midwest because of the costs of complying with the more stringent Phase 2 clean fuel guidelines that took effect this year, particularly in areas like Chicago and Milwaukee where corn-based ethanol is used to make cleaner-burning RFG.

During the summer months, refiners must use a special lower-volatility gasoline to blend with ethanol to make Phase 2 RFG. Yes, this lower-volatility gasoline costs slightly more, but the U.S. Environmental Protection Agency has repeatedly emphasized that it should add no more than five to eight cents per gallon to the total cost.

On the other hand, consider the fact that a gallon of ethanol delivered to Chicago/Milwaukee market is currently selling for \$1.28 to \$1.32 a gallon – well below the current price of gasoline. This means that blending less-expensive ethanol into gasoline actually *reduces* the cost of the finished gasoline. If we were not using ethanol in RFG in places like Chicago and Milwaukee, gasoline prices could be even higher than they are today.

But despite the economic and environmental benefits of using ethanol in RFG, EPA hasn't helped matters either. Despite our repeated urging, the agency has failed to make appropriate regulatory changes that could reduce the cost of producing Phase 2 RFG. Current EPA rules fail to give ethanol credit for its significant carbon monoxide reduction benefits. If these environmental benefits were fully accounted for, refiners could blend ethanol into their RFG much more cheaply and easily. But as the rules stand now, there's actually a *disincentive* to use ethanol in RFG.

Corn growers and ethanol manufacturers long ago geared up to meet the demands of Phase II RFG. With 58 facilities in 19 states, producers are making ethanol at a rate that exceeds 1.6 billion gallons per year. That means the United States is using 1.6 billion gallons *LESS* of gasoline than we would be otherwise. And we can easily make more ethanol to meet increased demand.

So from both a price and supply standpoint, you reach the inescapable conclusion: Ethanol is not the problem – it's the solution!

So why have gasoline prices gone so high?

No one seems to know the answer. But one thing we know for sure is this: Something smells in the barnyard.

That's why we asked the Federal Trade Commission to investigate. And why we applaud your looking into the problem, too.

The facts just don't add up:

- Crude oil prices have leveled off – so they cannot account for the recent price rise. The supply of crude is plentiful, at least if you believe ExxonMobil's recent statement that the company exceeded 100 percent replacement of its oil and gas reserves for the sixth year in a row.
- But meanwhile, oil companies have allowed gasoline inventories to drop to alarmingly low levels in many areas. And despite having had five years to prepare for Phase 2 RFG, refiners failed to build adequate supplies of low-volatility gas to blend with ethanol.
- Ethanol-blended gasoline should be selling for less than conventional gasoline. But since April, both RFG and conventional gasoline prices have risen at close to the same high rate – 34 percent and 29 percent respectively.

So, are we looking at price gouging by the oil industry? Or is this a cleverly orchestrated attempt to create a so-called crisis in order to get rid of the RFG requirement – which Big Oil has never liked despite RFG's proven benefits to the environment and consumers? Or is something else is at work?

My hope is that your good work and that of the FTC will get to the bottom of the matter.

I also hope you will use this occasion as a unique opportunity to craft a more rational national energy policy — one that expands the use of renewable fuels such as ethanol and domestic energy sources such as oil, coal and natural gas. By reducing our dangerous dependence of foreign oil, we can benefit the environment while increasing our energy security.

I'd like to read you a quote from four individuals who are among America's most distinguished national security leaders: Retired Air Force General Lee Butler, former National Security Advisor Robert McFarlane, former CIA Director R. James Woolsey, and the former Chairman of the Joint Chiefs of Staff, Admiral Thomas Moorer:

*Sitting on only 3 percent of the world's reserves while using 25 percent of the world's oil, nothing could be more short-sighted than for Americans to abandon the incentives for producing transportation fuel from sustainable sources. Such an abandonment would entrust the future of our energy supplies, and of key aspects of our security, to the potpourri of psychopathic dictators, such as Saddam [Hussein], and vulnerable autocrats who control over three-quarters of the world's supply of oil.*

Mr. Chairman and members of the committee, I hope you will heed those wise words. And I hope you will recognize that ethanol remains the answer – as the only fuel that is made from all-American sources, that is 100 percent renewable, that is clean burning and improves the quality of our air, that does not pollute the water, and that is eminently affordable. It benefits our national security, our environment, our economy and the American people. And it would be a tragedy if its use was impeded in any way as a result of what the oil companies are doing today.

Thank you for your time and I will be pleased to take your questions.

The Honorable Thomas Bliley, Jr.  
Chairman  
Committee on Commerce  
U.S. House of Representatives  
2125 Rayburn Building  
Washington, D.C. 20515

Dear Chairman Bliley:

As detailed in the attached response and in my testimony, we strongly believe that congressional action is imperative to prevent anti-competitive and anti-consumer practices in the development of a truly effective and functioning competitive electric market.

While I am hopeful that Ohio will not suffer the severe price spikes and supply disruptions that California is currently experiencing, it is clear that state actions alone can neither create effective competition nor thoroughly protect consumers. Electricity — by both physical and economic necessity — is transmitted and sold in an interstate market. To that end, only Congress can, and therefore it must, promote the appropriate structure for competitive interstate electricity markets.

I appreciate your interest in our position, as well as the opportunity to share our views with the Committee. Please contact me or OMEA Executive Director Jolene Thompson at 614/337-6222 if we can provide any additional information.

On behalf of the members,

**Marc S. Gerken, P.E.**  
**President**

**Attachment**

cc: AMP-Ohio Board of Trustees  
OMEA Board of Directors  
TAPS Members  
Alan Richardson, Executive Director, AFPA  
Marty Kanner, Legislative Counsel, Kanner and Associates  
Jolene M. Thompson, Executive Director, OMEA

**American Medical Union**



#### 1946 Community Union News



*September 11, 2000*

**Response of  
Marc Gerken, P.E., President  
AMP-Ohio  
to Questions from Chairman Bliley**

1. **Is regulatory uncertainty stifling investment in new power plants and the transmission grid? If so, what impact would eliminating this regulatory uncertainty by providing a national framework for the interstate transmission of electricity have on the reliability of the interstate transmission grid?**

Investment in generation is growing in most areas as some of the uncertainty surrounding state restructuring plans is answered at that level. In fact, Ohio's municipal electric systems through AMP-Ohio are in the process of completing work on a distributed generation project that has resulted in 156 MW of peaking capacity coming online over the past two years. And, Ohio reportedly has more than 3,000 MW of planned capacity on the drawing boards. However, the reality is that some of the planned capacity will not be constructed, at least in part due to problems associated with interconnecting generation to the transmission system, assuring transmission rights, and reaching markets in neighboring states. Establishing a single set of rules for all users and all uses of the transmission system would significantly improve the market for new investments in generation.

Investment in transmission, however, is lagging in Ohio and elsewhere. One clear problem is the challenge of siting new transmission facilities. Encouraging regional planning would be a helpful step. But an equally significant barrier to new transmission investment is the self-interest of the incumbent utility. Transmission represents a small percentage of an integrated utility's total plant investment. However, by maintaining a transmission constraint, a vertically integrated utility can exponentially inflate the economic value of its generation and simultaneously block entry by competitors who could challenge that market position. The best solution for encouraging transmission investment is the formation of truly independent regional transmission organizations with the authority and responsibility for operating, planning and expanding the grid.

2. **American Municipal Power's testimony highlights some examples of market power being exercised in such a way as to make the grid less reliable. Is this a common problem? Is this an economic problem or could such practices actually result in outages as electric power is kept off the grid?**

Market power abuse, while difficult to prove, appears to be growing. Transmission dependent utilities like Ohio's municipal electric systems, large industrial customers, and competitive power suppliers all have experiences that suggest the abuse of market power. The difficulty of proving market power abuse keeps all but the worst offenses out of the public eye. But, as San Diegans are now realizing, the costs of those abuses are ultimately borne by end-use consumers. In addition to the significant economic consequences of market power abuse, the exercise of market power can also impact reliability. First, parties possessing market power can manipulate generation or transmission facilities to create or exacerbate a supply shortage. In the extreme — when unexpected weather conditions or equipment outages occur, or when those seeking to create and profit from a shortage simply guess wrong — this could result in supply disruptions. Equally significant, the exercise of market power can prevent the entry of new market participants and create a sustained period of supply shortages.

3. **What impact will the formation of regional transmission organizations (RTOs) have on the reliability of the grid? How do the functions of RTOs overlap or compliment the organizations contemplated by the consensus language promoted by the North American Electric Reliability Council?**

Formation of properly structured RTOs will have a positive impact on grid reliability. First, an independent party — not a vested economic interest — will determine available transmission capacity and facilitate a well-functioning market. Second, a transparent market will inspire confidence among participants and encourage new investment. Third, if RTOs perform the security coordinator function, then system reliability will be pursued for "pure" motives — not commercial gain. Fourth, if granted responsibility for planning and expanding the grid, RTOs can relieve constraints that impair system reliability.

However, these benefits will not be realized if RTOs are improperly structured. For instance, we believe that splitting Ohio between two RTOs would harm reliability and stifle competition. Similarly, allowing for the continuation or "phase-out" of pancaked rates will narrow the relevant market and limit the sources of power needed to promote reliability. And failing to provide true independence will undermine the entire intent. We don't simply need RTOs, we need good RTOs.

The consensus reliability legislation assumes that individual utilities — rather than RTOs — will serve as control area operators and security coordinators. However, the legislation can easily be rationalized to support the assumption of those responsibilities by RTOs. It is imperative that these responsibilities are transferred to only “good” RTOs and that FERC maintain the appropriate level of oversight.

4. **Your testimony highlights the difficulties of interconnecting new generation facilities to the interstate transmission grid. What impact could greater use of distributed generation technologies have on reliability? What is your position on the development of uniform interconnection standards in Federal legislation?**

Distributed generation has the advantage of being located at the load center. As such, distributed generation can greatly improve reliability by avoiding dependence on the transmission grid. The previously referenced AMP-Ohio distributed generation project is one such example.

Adoption of uniform interconnection standards for distributed generation could prove beneficial, but only if the standards are properly designed and structured. Development of uniform engineering standards could prove helpful in promoting reliability and discouraging unsafe practices. However, AMP-Ohio would not support standards that threaten system reliability, fail to recover the cost of the interconnection, create cost-shifts to other distribution customers, or impinge on the Home Rule protections afforded municipalities under the Ohio Constitution. In light of legitimate local considerations, including right of way issues, such concerns are shared by municipal electric communities outside Ohio as well as cities and villages that do not operate electric systems. It is our understanding that APPA, our national association, is working with representatives of the distributed generation industry to develop language to address these issues.

5. **Some argue that “incentive” rates are needed to lure the investment necessary to build new transmission lines. Your written testimony highlights some of the reasons why such “incentives” are unnecessary. What impact would “incentive” rates have on the prices paid for electricity by consumers? Is it sometimes in an incumbent utility’s interest to not build new transmission lines even though there are significant constraints? Please provide specific examples.**

Put simply, “incentive” transmission rates would force consumers to pay more for power than they should.

For example, provisions of H.R. 2944 would provide incentives for utilities joining RTOs. Why should First Energy receive a “bonus” payment for taking action it is already required to do under the terms of its merger approval?

Moreover, “incentive” rates will provide unnecessary profits without necessarily accomplishing one of the stated intents — relieving transmission constraints. Incumbent utilities can earn substantially greater profits by maintaining a constraint and boosting the prices they can charge for generation within that constrained market than they would receive in incentives for relieving the constraint. And, under incentive rate proposals, which would typically boost the rate of return earned on transmission facilities, a utility in these circumstances would nevertheless earn that incentive return even on its intentionally constrained facility.

The greatest “incentive” that can be provided for relieving transmission constraints is vesting responsibility for relieving such constraints with an independent RTO.



BOARD OF GOVERNORS  
OF THE  
**FEDERAL RESERVE SYSTEM**  
WASHINGTON, D. C. 20551

ALAN GREENSPAN  
CHAIRMAN

July 11, 2000

The Honorable Thomas J. Bliley  
Chairman  
Committee on Commerce  
House of Representatives  
Washington, D.C. 20515

Dear Mr. Chairman:

You have asked for my views on the potential benefits of increased competition in electricity markets. The market for electricity in the United States has a complex structure, and I am not familiar with the details of the reform plans being proposed. Nonetheless, I am pleased to provide you with some general comments.

Recent experience with deregulation in a number of industries does provide evidence that it can provide substantial benefits to the economy and to consumers. We have seen that, by fostering greater competition, deregulation not only can lead to lower prices for goods and services but it can also unleash entrepreneurial forces that lead to creative and beneficial innovations that often cannot be foreseen.

The effects of further deregulation in the market for electricity likely will not be uniform across regions or across individual utilities and customers. Nonetheless, it is safe to assume that a move to a more competitive environment will result, on the whole, in gains in economic efficiency and consumer welfare. With that in mind, and given the substantial size of investments and the long gestation periods for new generation and transmission facilities, I would think it most constructive to clarify the framework in which interstate commerce in the electricity market will operate in the coming years.

I hope that these few comments are of some value as you and your colleagues proceed with your important work on this issue.

Sincerely,  
A handwritten signature in dark ink, appearing to read "Alan Greenspan", written over the word "Sincerely,".